THE NEW DEMOCRAT

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WINTER 2001

BLUEPRINT

IDEAS FOR A NEW CENTURY

10 BIG IDEAS

A New Democrat agenda for governing

1. BOOSTING NEW GROWTH ECONOMICS
2. CLOSING THE STUDENT ACHIEVEMENT GAP
3. MODERNIZING MEDICARE
4. ACHIEVING UNIVERSAL HEALTH INSURANCE
5. SAVING MORE FOR RETIREMENT
6. FINISHING THE WELFARE REVOLUTION
7. TRANSFORMING AMERICA'S MILITARY
8. CREATING NEW TOOLS FOR A CLEAN ENVIRONMENT
9. FIGHTING CRIME IN THE DIGITAL AGE
10. PROMOTING FREE TRADE IN THE AMERICAS

Democratic Leadership Council

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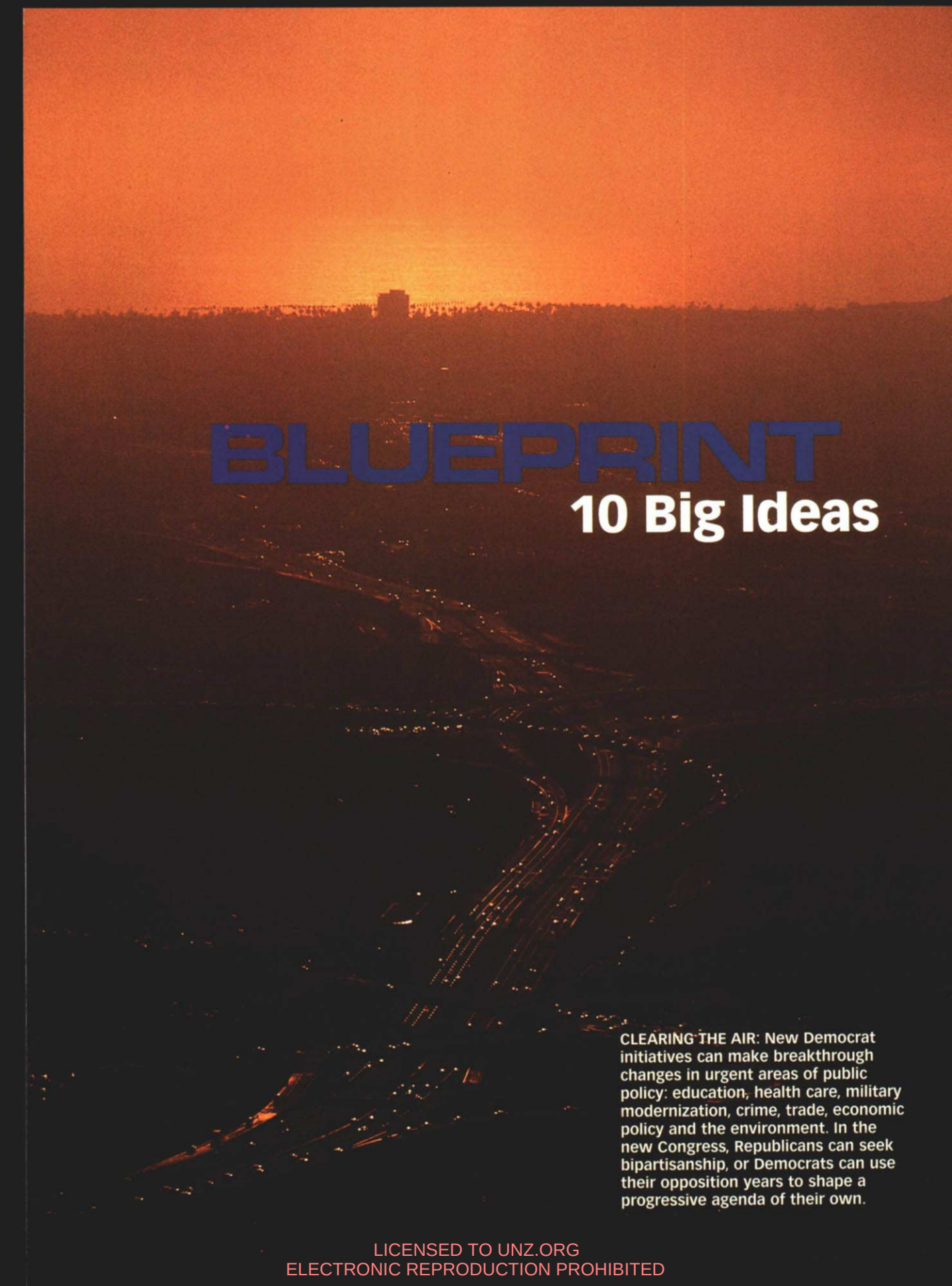

BLUEPRINT

10 Big Ideas

CLEARING THE AIR: New Democrat initiatives can make breakthrough changes in urgent areas of public policy: education, health care, military modernization, crime, trade, economic policy and the environment. In the new Congress, Republicans can seek bipartisanship, or Democrats can use their opposition years to shape a progressive agenda of their own.

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THE NEW DEMOCRAT
BLUEPRINT

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Policy publications are not divorced from politics. On the contrary, ideas and politics are willing bedfellows. Successful policy wonks operate in the same world as the people who count votes and take polls.

So it is with BLUEPRINT. When this issue was conceived, however, we had a different policy-and-politics constellation in mind: one with a Democrat in the White House and a possible Democratic majority in at least one house of Congress. Things turned out differently. Still, our agenda remains valid. It is a road map for progressive policies that can help America fulfill its promise in the 21st century. It is a compilation of big ideas that make paradigmatic leaps in social, economic, and foreign policy. No matter which government had come to power — Bush's or Gore's — this agenda would be pressing national business.

Unlike recent issues of BLUEPRINT, which concentrated on a single policy topic, this one covers the waterfront of public debate. It is a sweeping tableau of initiatives ranging from education to crime to health care to new growth economics. It covers welfare, defense, the environment, and trade. Some of the ideas are long overdue: a prescription drug benefit, a revolution in military affairs, greater school accountability, universal health care. Others are refreshingly innovative: mandatory drug treatment for all prisoners, fighting crime with information, a second generation of environmental action.

As a fundamental document of progressive ideas, this issue can serve as a workaday guidebook for Democrats who want a policy agenda for the opposition years. These ideas point a way forward at a time when the two parties are at virtual parity; bipartisanship must be the order of the day if we are to accomplish anything. At the same time, they honor the progressive tradition of Democratic politics.

The Democratic Leadership Council has always believed that ideas matter most in politics. These ideas can help define Democrats in the loyal opposition and serve as a rallying point for building a new progressive majority.

—Peter Ross Range

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Issue 9

1 EDITOR'S NOTE
by Peter Ross Range

4 10 BIG IDEAS FOR THE NEW CENTURY
Democrats in the opposition must propose progressive alternatives for solving America's problems.

6 THE NEW GROWTH ECONOMICS
by Robert D. Atkinson
How to boost living standards through technology, skills, innovation, and competition.
Plus: Thinking Outside the Box

14 THE NEW THREE R'S OF EDUCATION
by Andrew Rotherham
Putting results and accountability at the top of the agenda will drive performance up.
Plus: Fighting Entrenched Resistance

20 A NEW MEDICARE FOR THE NEW ECONOMY
by Jeff Lemieux
The boomers are coming. It's time to modernize the system.

26 COVERING THE UNINSURED
by David Kendall, Jeff Lemieux, and S. Robert Levine, MD
Ways to make health insurance available and affordable to 43 million Americans.

32 SAVING FOR RETIREMENT
by Jeff Lemieux
Using tax credits to boost private savings.

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34 MAKING WORK PAY
by Will Marshall
Welfare reform helped people get jobs. Now we need to make sure they can earn a living from their work.
Plus: Welfare Reform: A Progress Report
Tax Relief for Working Families *by David R. Reimer*
Double the child tax credit *by Anne Kim*

44 WHY IT'S TIME TO REVOLUTIONIZE THE MILITARY
by James R. Blaker and Steven J. Nider
If we don't speed up the shift to a modernized, fully wired military, hostile powers could use information technology to counter our dominance in conventional forces.

50 LICENSE TO INNOVATE
by Debra S. Knopman
An agenda to modernize the tools of environmental protection.
Plus: The Five Essentials for Second Generation Environmentalism
Stalemate in The Hague

56 CRIME STORY: THE DIGITAL AGE
by John D. Cohen, Adam Gelb, and Robert Wasserman
Harnessing new technologies to community policing.
Plus: The Carrot and the Stick *by Eric B. Schnurer and Charles R. Lyons*

62 THE FREE TRADE AREA OF THE AMERICAS: WHY THE UNITED STATES MUST TAKE THE LEAD
by Jenny Bates
Without aggressive leadership, the United States may lose out in the competition for Latin American markets.

68 POSTSCRIPT: A NEW DEMOCRAT TAX CUT
by Jeff Lemieux
Six questions we should ask

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10 big ideas for the new century

by The Editors

Democrats in the opposition must propose progressive alternatives for solving America's problems.

For the first time since President Eisenhower's day, Democrats do not control the White House or either house of Congress. However narrowly, Republicans control the levers of power and Democrats are in opposition. As the opposition, Democrats have a duty to oppose, but also an opportunity to propose — to offer the nation progressive alternatives for confronting America's biggest challenges. The party's long-term interests will not be well served by tactical positioning designed only to stymie Republican initiatives or embarrass a Republican president. Over the next four years, Democrats should define themselves not only by what they are against but by the ideas and enduring values they stand for, now and in the future.

In that spirit, we offer ten bold ideas for grappling with our nation's most pressing problems. They are grounded in the core New Democrat values of opportunity, responsibility, and community. If the Republicans are seriously interested in breaking partisan gridlock and governing from the "vital center," these ideas can be the basis of bipartisan efforts to strengthen our nation. If not, these ten ideas can define the progressive alternative for years to come.

IDEA#1 New growth economics

With the emergence of the New Economy in the 1990s, America broke out of a decades-long period of anemic economic growth that bred stagnant wages and growing economic inequality. Amid signs of an economic slowdown, it's critical that policymakers focus on what it takes to keep our economy on the current path of high productivity growth — the key to rising incomes and living standards for all. Robert D. Atkinson says it's time to discard obsolete Keynesian and supply-side doctrines and replace them with a new growth economics focused on boosting productivity and wage growth through investment in knowledge, public support for competition and innovation, and continued fiscal discipline.

IDEA#2 Redefining Washington's role in education

Raising the quality of public schools topped the list of voter concerns in the 2000 election. Washington plays a limited but crucial role in public education, having assumed special responsibility for assuring equal educational opportunity for disadvantaged children. The opportunity is at hand for the new administration and Congress to play a key supporting role in education reform, as the main federal school aid programs come up for reauthorization this year. Andrew Rotherham proposes a sweeping overhaul of those programs to align them with the states' drive toward greater educational accountability and performance. He calls for a "grand bargain" in which Washington offers more spending and flexibility while demanding more accountability for lifting student performance and closing the achievement gap between poor and middle-class students.

IDEA#3 Modernizing Medicare

Both candidates in last year's election called for adding a prescription drug benefit to Medicare, the nation's health care program for seniors. They were right. Created in 1965, Medicare's benefits have lagged behind what is generally available from private health insurance plans. The key to modernizing Medicare, says Jeff Lemieux, is not just to legislate new benefits, but to build in incentives for constant innovation by encouraging more competition with private plans. This approach will expand choices for seniors, provide more up-to-date medical benefits, and use market competition rather than government price controls to constrain Medicare's unsustainable cost growth. It has been championed in Congress by the bipartisan duo of Sen. John Breaux (D-La.) and Sen. Bill Frist (R-Tenn.).

IDEA#4 Universal health care, American style

The public's top priority for health care isn't prescription drugs or HMO reform, it's expanding coverage to the 43 million Americans who are uninsured. David Kendall and his co-authors propose a new path to universal health care based on the principle of public financing for private insurance. Central to this plan is a refundable tax credit, which would help needy families buy health care coverage. Other key elements include group purchasing arrangements, report cards on the performance of competing

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health plans, and measures to keep insurers from "cherry picking" healthy customers at the expense of the sick. By balancing societal and individual responsibility, say Kendall et al, this approach offers a decentralized alternative to a national health care system for achieving the long-sought progressive goal of universal coverage.

IDEA#5 Saving for retirement

Whether or not there is a serious debate about Social Security reform this year, there is a growing consensus that Americans need to save more to finance a comfortable retirement. Both presidential candidates proposed costly initiatives to boost personal savings, within the Social Security system in Bush's case; outside it in Gore's. As Jeff Lemieux points out, raising personal savings has the same economic impact as buying down the national debt: It boosts the supply of capital available for productive investment, keeping interest rates low. Helping low-income families save would boost national savings overall while helping those families build wealth over the course of their working lives.

IDEA#6 Making work pay

A major task awaiting the new administration and Congress is completing today's unfinished welfare revolution. Since President Clinton signed a 1996 law "ending welfare as we know it," the number of people on public assistance has fallen by nearly 60 percent. Having made work a universal obligation for those seeking society's help, society must now do its part by helping people find jobs and making sure that work pays enough to provide them a decent living standard. Will Marshall proposes steps to remove obstacles to work for those who remain on welfare as well as a new system of public supports that will enable working families generally to lift themselves out of poverty. David Reimer and Anne Kim add proposals for tax reforms aimed at eliminating the marriage and work penalties that current social policies unintentionally impose on low-income families.

IDEA#7 Defense in the Information Age

America's military has been painfully slow in adapting to a rapidly changing global security environment. More than a decade after the Soviet Union collapsed, we still maintain a ponderous force shaped by Cold War threats and war-fighting doctrines. James Blaker and Steven Nider argue that to stave off a slow erosion of U.S. military superiority, we must accelerate the transformation of our military into a faster, more agile, more efficient, and more effective force promised by the American Revolution in Military Affairs. Among other things, this means restoring the primacy of civilian leadership in defining future military requirements, breaking down service fiefdoms to promote joint operations, and reducing bureaucratic bloat in the Pentagon.

IDEA#8 New environmental action

Since the first wave of national environmental laws and policies were launched three decades ago, America's air, land, and water are much cleaner and industrial pollution has been dramatically curbed. Today, however, we face a new array of problems — climate change, pollution from farms and development, the destruction of habitat and rare species — that cannot be solved by the old top-down mandates. As Debra Knopman argues, America needs a "second generation" of environmental activism that develops new tools for dealing with new threats to the domestic and global environment. She urges the new administration to throw its weight behind a bipartisan "second generation" bill in Congress that gives citizens, businesses, and local communities a "license to innovate" and find more effective and efficient ways to meet and exceed national environmental standards.

IDEA#9 Digital crime fighting

After falling steeply in the 1990s, violent crime rates appear to have leveled off and may even be trending up again. This calls for a creative response from national lawmakers as well as law enforcement officials. John Cohen and his coauthors propose a new strategy for fighting crime that builds on the success of community-oriented policing around the country and emphasizes how advanced technology can strengthen and modernize the criminal justice system. Their three-part strategy includes new federal support for local police efforts to acquire and deploy the latest information and communications devices; help in targeting crime "hot spots" and high-risk offenders; and replacing the invidious practice of racial profiling with "criminal targeting." Eric B. Schnurer adds a compelling argument for mandatory drug treatment of America's criminal population.

IDEA#10 Free Trade in the Americas

This spring, leaders from around the hemisphere will gather in Quebec to discuss creation of a Free Trade Area of the Americas (FTAA) — a $10 trillion common market of 800 million people stretching from the Yukon to Tierra del Fuego. The Bush administration, says Jenny Bates, must seize the opportunity to assert U.S. leadership in concluding an agreement that can open lucrative new markets while also advancing U.S. foreign policy goals. Taking a page from the European Union, she proposes a "democracy" standard for admission to the FTAA, which would create a powerful incentive for continued progress toward democratic reforms and help to isolate the region's strongman regimes. ■

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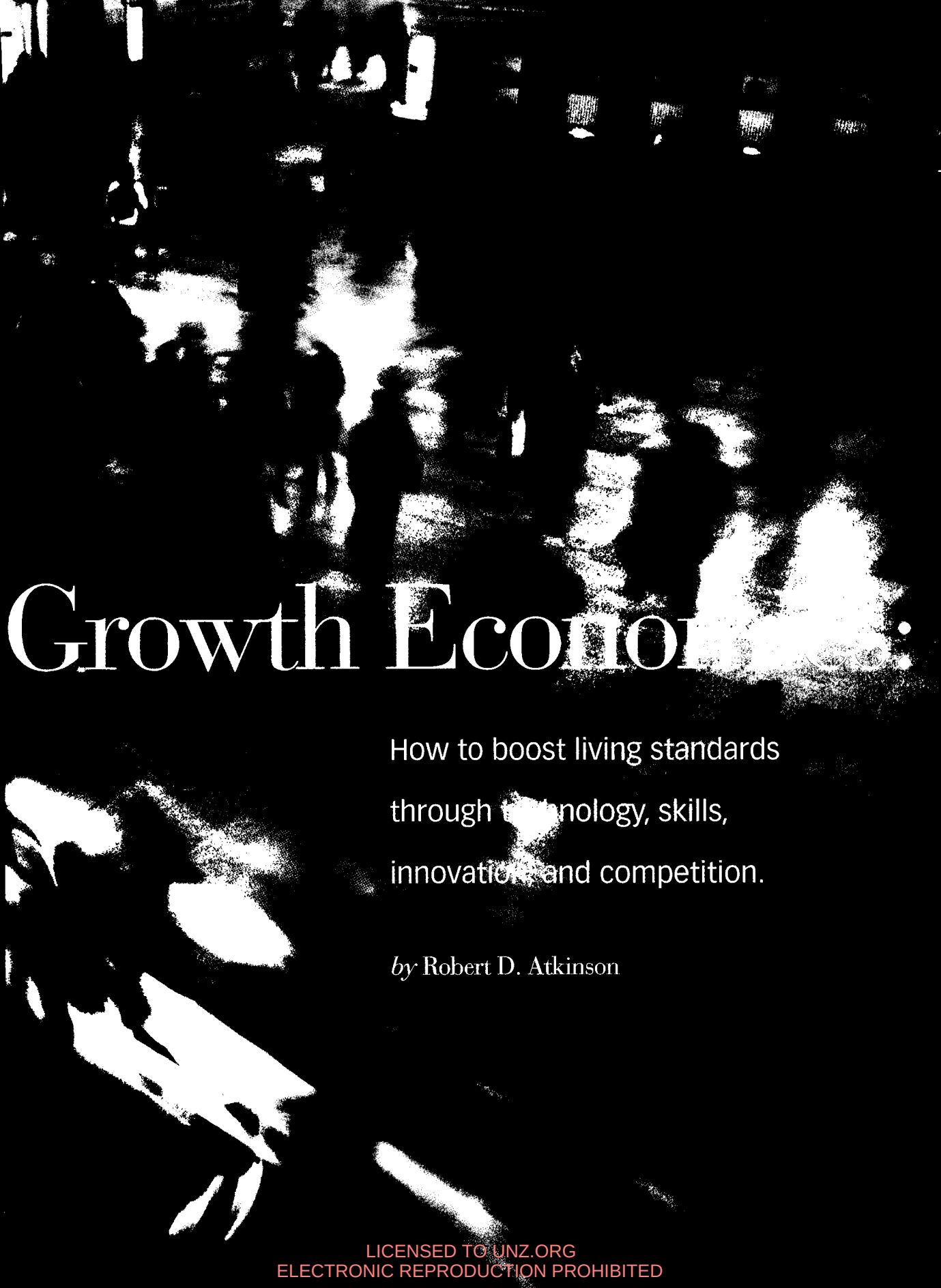

Growth Economics:

How to boost living standards through technology, skills, innovation and competition.

by Robert D. Atkinson

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"Because supply-side economics was a reaction against the old system, not a development designed to meet the realities of the New Economy, it did not produce the results its advocates promised."

John Maynard Keynes once wrote that "practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist." That's exactly the situation among today's economic policy makers: As the New Economy continues to displace the Industrial Age economy, our policies are still rooted in that earlier age. While the Clinton Administration took significant steps to move its policy framework into the new era, much remains to be done. That's why the new administration should jettison the holdover prescriptions of Keynesian and supply-side economics, with their overriding focus on the business cycle. Instead, the White House should embrace growth economics focused on boosting productivity and wage growth through investment in knowledge, support for competition and innovation, and fiscal discipline. By raising national productivity by only one-half to one percent, the new president can help generate significant improvements over time in the living standards of all Americans.

Legacy Economic Policy Systems

The foundations of our economic policy system were laid in the 1940s, when that period's own "New Economy" was also emerging. Memories of the Great Depression and the fear of another depression following the conversion from a wartime economy, coupled with the insights of Keynes, led to the passage of the Employment Act of 1946. The Act stated that it was the "continuing policy and responsibility of the Federal Government to use all practicable means ... to promote maximum employment, production, and purchasing power." The goal of the legislation, and indeed the central organizing principle of U.S. economic policy to this day, has been not to boost long-term growth of the economy, but rather to make sure that recessions don't cause our economic performance to slip below some natural, immutable rate of growth. (In the last two decades the goal of keeping inflation low has been added as well.) When the Act spoke of maximizing production it meant avoiding recessions, running factories at full capacity, and getting to full employment. Government would do this through demand management — controlling the money supply and federal spending and taxing to boost or restrict consumer spending and company investment depending upon the phase of the business cycle.

The Act was silent on productivity — the key to income growth — in part because economists knew little about productivity and even less about how to boost it. It's only in the last decade that mainstream economics, led by Stanford economist Paul Romer, has begun to focus on why income growth occurs, focusing in particular on the key role of knowledge.

The Supply-Side Sidetrack

By the 1970s, conservatives and liberals shared President Richard Nixon's view that "we are all Keynesians now." However, the emergence of high unemployment with high inflation — a phenomenon that was not supposed to be possible under the old Keynesian model — coupled with a dramatic slowdown in productivity growth soon led many to question the prevailing economic doctrine.

In particular, conservatives, inspired by Jude Wanniski's *The Way the World Works*, attacked Keynesian "demand-side" economic policy. The new supply-side doctrine postulated that the real issue was that high taxes reduced incentives for companies and individuals to invest capital and for workers, particularly high earners, to work more hours. As a result, they argued that sizable tax cuts, particularly for upper-income Americans and businesses, combined with regulatory relief, would stimulate investment and job growth.

Because supply-side economics was a reaction against the old system, not a development designed to meet the realities of the New Economy, it did not produce the results its advocates promised. Conservatives argue that the current economic boom actually began during the Reagan Administration. Yet while it's true that jobs grew then, the growth was largely the result of an unprecedented entry into the labor force of baby boom workers and women. The real measure of success — productivity and wage growth — slowed to a 100-year low.

As a doctrine, supply-side economics failed.

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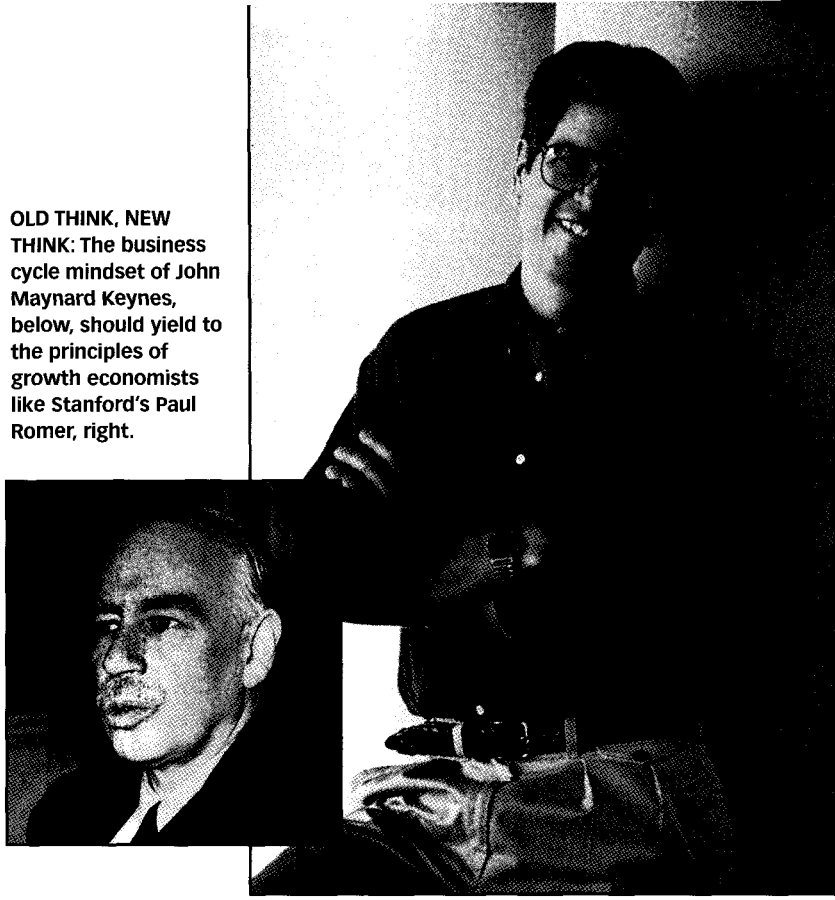
It failed because supply-siders were looking at old economy factors — capital and labor supply — and not at New Economy factors of capital and labor quality. These are determined by knowledge, technological innovation, and competition, as well as by education and training. Moreover, even if one were to grant that the supply of capital and labor is the key, it was never clear why reductions in personal tax rates, for example, would stimulate companies to develop or adopt technologies leading to higher productivity.



OLD THINK, NEW THINK: The business cycle mindset of John Maynard Keynes, below, should yield to the principles of growth economists like Stanford's Paul Romer, right.

The New Growth Economics

As the Progressive Policy Institute has articulated in its *New Economy Index*, the New Economy is more global, more knowledge-driven, more entrepreneurial and dynamic, and driven by digital technologies. In this New Economy, neither Keynesianism nor supply-side economics provide the right answers because today's economy is fundamentally different than the one of even 15 years ago. The Clinton Administration moved toward a new conception of economic policy. It's time to build upon that and fully embrace growth economics.

This means placing the focus of economic policy squarely on boosting per-capita incomes, and that means focusing on productivity. As Paul Romer states, "the most important economic policy question facing the advanced countries of the world is how to increase the trend rate of growth of output per capita."

It may seem obvious that productivity growth should be the object of our economic policies, but strikingly, both liberal and conservative economic doctrines want to take a shortcut to growth, focusing not on productivity but on redistribution. Conservatives want to raise after-tax income by cutting taxes — taking from public expenditures to boost private incomes. Liberals want to tax the rich more, dramatically increase the minimum wage, and spend much of the surplus to funnel the proceeds to programs to benefit "working families." Neither approach recognizes that the only long-term answer to improving the economic well-being of Americans is to focus on productivity.

In addition, neither liberals nor conservatives embrace fiscal discipline. Conservatives would see the surplus go to tax cuts, not paying off the debt. Some have even recently begun preaching supply-side Keynesianism, arguing that large tax cuts are needed to spur consumer demand. Many liberals continue to believe that because government spending boosts consumer demand it leads to more jobs and in turn higher wages (but lower profits or higher inflation since higher wages would have to result from increased bargaining power by workers, not higher productivity). As a result, they attacked efforts by the Clinton administration to pay off the debt, calling it Calvin Coolidge economics. Yet, with full employment, cranking up large new spending programs or tax cuts would only produce inflation and efforts by the Federal Reserve to counteract the stimulative effect.

Growth economics also challenges the mistaken notion of natural limits to growth. Until last year, most economists postulated that the economy could not grow faster than 2 percent to 2.5 percent per year without sparking inflation. Growth economics recognizes that the economy can grow much

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Thinking outside the box

Creating a "skunk works" for the federal government

No matter how hard the Bush administration wants to focus on the big picture and act strategically, within a matter of weeks after taking office, political appointees at all levels are likely to get bogged down putting out fires and dealing with the day-to-day job of governing. Moreover, the federal bureaucracy focuses more on managing its programs than it does on understanding a rapidly changing environment and designing interventions that serve as catalysts for change. And finally, strategic thinking across agency/bureau lines rarely happens and is in fact discouraged because of budgetary procedures and other factors. Combine all of these elements and you get a federal enterprise that has become reactive and programmatic.

But this difficulty in being flexible, strategic, and visionary is not confined to the federal government — it is endemic to all large organizations in the New Economy. In contrast to the federal government, large corporations have responded to these kinds of inherent limitations in a myriad of ways. One way has been to create "skunk works" — havens in the company that are focused on creativity, the future, and breakthrough changes in how business is done. The term "skunk works" came from the innovative unit that the aerospace company Lockheed Martin established more than 50 years ago to "think outside the box" and develop the next generation of technologies and products. Lockheed describes the key to its success as being able to "identify the best individual talents in aviation, blend and equip them with every tool needed, then provide complete creative freedom so they may arrive at an optimum solution in short order.

Skunk works have been emulated by Ford Motor Co., McDonnell Douglas, and many other companies as a means for developing products quickly, cheaply, and effectively. Within government, the Blair administration in the United Kingdom has created a unit (two-thirds of it staffed by business people seconded from industry) inside its Department of Trade and Industry focused solely on innovation and futures planning for government.

PRIMING THE BRAIN PUMP: Breakthrough technologies like the U-2 spy plane, above, were the outcome of intense, unfettered R&D at the Lockheed Martin skunk works. The same creativity could energize policy thinking at a government skunk works.

Effective governing in the New Economy, in either business or government, means thinking strategically about changes and challenges in the world and reacting quickly and strategically to make a positive difference. Doing this in the federal government is hard. As a result, the Bush administration should create its own skunk works.

But to do it right, it will have to be non-bureaucratic. Skunk works aren't big on titles, protocol, or rules. They stay away from bureaucratic management, enabling the members to work quickly and efficiently with a minimum of corporate oversight. If they don't do this, they can't attract the kind of creative, policy "extroverts" — people who network widely and often travel outside the Washington Beltway — that are needed for such an operation to work. But at the same time, skunk works need to be linked to decision makers if their ideas are to be translated into reality. For that reason the skunk works should be in the executive office of the president, with close links to the Office of Management and Budget.

A skunk works is just one idea that the Bush administration should embrace if it is to transform bureaucratic government into catalytic and entrepreneurial government. Embracing a radical government re-engineering strategy will mean adopting a host of other reforms, including consolidated, performance-based grants; fundamental civil service reform, consisting of greater flexibility for hiring, firing, and compensation; allowing agencies that cut costs to retain savings; creating accountable, performance-based organizations to foster digital, customer-centered government; and providing funding and flexibility for "intrapreneurial" new government start-up efforts. The New Economy demands a new organization of the federal government, and making this a reality should be a top priority of the Bush administration.

— Robert D. Atkinson

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faster without inflation, as long as productivity grows as fast. In fact, the new administration should set a goal to double living standards for American workers within 30 years. This would require maintaining an annual productivity growth rate of 2.5 percent — even less than the 2.7 percent productivity growth rate the country has seen since 1996.

Embracing growth economics does not mean ignoring past economic policy goals, such as job creation and inflation control. While these still matter, they are no longer central. The information technology revolution, as well as a highly competent Federal Reserve policy, has led to the longest expansion in economic history. Because globalization, increased market competition, and the technology revolution have reduced the threat of inflation, the Federal Reserve does not need to induce anti-inflationary recessions as much as it used to. Although as evidenced by its repeated interest rate hikes in the last 18 months, the Federal Reserve Bank may not have fully heeded its own lesson.

The Foundations of Growth Economics

Growth economics has emerged because of the growing recognition that the economic models created in the Industrial Age dominated by commodity goods production no longer adequately explain growth in an economy powered by knowledge and innovation.

While Keynesian and supply-side economics focused in an almost Newtonian way on adjusting the demand or supply of capital and labor to keep the economy in equilibrium, growth economics is focused on a different set of questions related to how the New Economy creates wealth: are entrepreneurs taking risks to start new ventures; are workers getting skilled and are companies organizing production in ways that use those skills; are companies investing in technological breakthroughs and is government supporting the technology base (e.g., funding research, training scientists and engineers); are regional clusters of firms and other institutions fostering innovation; are we avoiding protecting companies against more innovative competitors; are research institutions transferring knowledge to companies; and are policies supporting the ubiquitous widespread adoption of the Internet and other advanced information technologies?

Under the old economic policy model, it was not clear that there was a role for government in economic policy beyond managing the business cycle and protecting intellectual property rights. Growth economics makes it clear that government policies can boost long-term income growth. It recognizes the conservative insight that free markets, competition, and innovation boost growth. But it also recognizes the liberal insight that government investments, particularly in science, technology, education, and skills, can provide a foundation upon which productivity growth depends. And finally, growth economics recognizes that fiscal discipline underlies all of this. As a result, growth economics leads to three overriding policy prescriptions:

1) Invest in Knowledge. Economists have long agreed that technology is the most important engine for economic growth. But their economic models couldn't really say how technological innovation spurred productivity or even occurred. New economic research not only recognizes the importance of technical advances but also explains how the process occurs and describes the key role of government in the process.

But it's not just technology that's key to productivity, it's the ability of workers to develop and use technology. The New Economy requires higher levels of education, including high-tech skills, and opportunities for lifelong learning to keep up with the constantly evolving demands of the Information Age.

As a result, growth economics focuses on increasing technological innovation, including support for research and development in the public and private sector, and on increasing the education and skills of the workforce and the ability of firms to use these skills.

In 2000, the Progressive Policy Institute's New Economy Task Force proposed a host of new investments in research and training. The new administration should build on these recommendations and significantly support funding for science, technology, education, and skills. For example, the next budget should

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increase investments in federal civilian research by 10 percent (in real dollars) and continue that increase every year until federal support for research is double today's level. The administration should also increase funding for Department of Defense research. It should not only make permanent the R&D tax credit but expand it. It should provide incentives to companies to train workers and work with states to jointly fund industry-led training alliances. And it should significantly increase funding for scholarships and fellowships for science, math, and engineering education.

2) Promote Competition and Innovation. Economists have long acknowledged that competition keeps prices down. The New Economy creates another critical reason for competition: It drives innovation and ultimately provides the greatest benefits to consumers. The next administration should focus on fostering economic competition through expanded trade and globalization, economic deregulation, and promotion of e-commerce competition.

Global integration, open markets, and increased trade allow the U.S. economy to specialize more in the higher value-added activities that it does best. They also increase economic competition, keeping prices down and fostering innovation. As a result, global integration is a key component of growth economics.

Domestically, growth economics means that if government is to promote growth it must facilitate, rather than resist, economic competition. This means moving away from regulating monopolistic or oligopolistic industries and instead promoting competition to achieve public interest goals of lower costs, new products, and greater consumer choice. It also means developing a modern understanding and application of antitrust law to prevent anti-competitive practices.

Growth economics also means not giving in to special interests fearful of change or falling sway to special pleading of incumbent firms threatened by competition. These protectionists need to be rebuffed in a host of areas — including their opposition to bioengineered foods that promise dramatic increases in agricultural productivity, their opposition to mergers that promise heightened efficiencies, and their opposition to those seeking government intervention to shelter them from e-commerce competitors.

Finally, it means crafting a legal and regulatory framework that supports the growth of the digital economy, in such areas as taxation, privacy, digital signatures, telecommunications regulation, and industry regulation (in banking, insurance, and securities, for example).

3) Maintain Fiscal Discipline. While the Bush administration should significantly increase investments in science, technology, skills and education, it should also maintain fiscal discipline and continue to expeditiously pay down the debt. Doing so results in lower interest rates enabling a virtuous cycle of more investments, more growth, and greater surpluses to pay off more of the debt. In a global market that disciplines nations for poor fiscal policies, fiscal discipline is increasingly a requirement.

"Historically, key economic policymaking posts have been held by economists grounded in old economy macroeconomic theory. Most economists are not trained in growth economics and do not understand the factors leading to productivity growth."

It's Time to Implement Growth Economics

Historically, key economic policymaking posts have been held by economists grounded in old economy macroeconomic theory. Most economists are not trained in growth economics and do not understand the factors leading to productivity growth. Princeton University economics professor Paul Krugman reflects the conventional view when he states: "We [economists] really don't know why productivity growth ground to a near halt [in the '70s and '80s]. That makes it hard to answer the other question: What can we do to speed it up?" Since Krugman (and most conventionally trained economists) don't know the answer to this, he counsels us to "diminish our expectations."

The principal advisers on economic policy to the new administration need to be individuals who know how to speed up productivity and encourage us to expand our expectations. Therefore, the new administration should appoint individuals grounded in growth economics and technological innovation to head the Council of Economic Advisers, the

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INVEST IN KNOWLEDGE: To boost growth, we need to support innovation and research, like the studies in this lab in North Carolina.

"The new administration should support policies that increase standards of living, embracing investment, tax, trade, and regulatory policies that advance that goal."

National Economic Council (NEC), the Treasury Department, and other key economic posts (e.g., Department of Labor, Department of Commerce). In addition, the new administration should create a National Economic Policy Council as part of the NEC. The council should be chaired by the vice president and include as members the heads of major business and labor organizations, CEOs, university presidents, and other civic leaders.

Finally, the new administration should support policies that increase standards of living, embracing investment, tax, trade, and regulatory policies that advance that goal and rejecting policies that do not. In particular, it should significantly increase investment in research and technology (including the associated mechanisms to utilize that technology) — as well as in the training and education of workers.

But at the same time the new administration needs to level with the American people. We can either hold on to the old framework and possibly preserve some semblance of the old economic security or we can embrace the New Economy and growth economics. If we do, workers will face increased risks and challenges (e.g., increased requirements to take control of their own lifelong learning, higher risks of being displaced from a job), but they will also reap greater rewards (faster income growth, more rewarding work, and more free time). It is time for growth economics to replace business cycle economics as the dominant organizing framework for U.S. economic policy. ▣

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The new Three R's of education

Putting results and accountability at the top of the agenda will drive performance up.

by Andrew Rotherham

A major and early challenge to the new administration will be its ability to respond to the public's appetite for education reform. Education was a major theme during the campaign, and both candidates promised to increase accountability in federal education policy and promoted a more muscular role for the federal government in elementary and secondary schooling. While there is not a consensus about what that role should be, the rhetoric of both the presidential campaign and the dialogue in Washington signals a bipartisan recognition that the federal government can and should play a role in elementary and secondary education.

The last Congress failed to reauthorize the Elementary and Secondary Education Act (ESEA) for the first time since its inception in 1965. ESEA is the federal statute governing most federal involvement in elementary and secondary schools. Therefore, ESEA reauthorization will provide a crucial and early test of the new administration's commitment to meaningful education reform. Lawmakers can tinker with the status quo by focusing on inputs, compliance, and programs. Or they can break the mold with an approach that positions Washington as a catalyst for innovation and success, modernizing ESEA with a focus on outcomes and results rather than inputs and process. In the Information Age, Washington must be a relentless driver of success, a catalyst for innovation and research, and must ensure that all students, regardless of where they live, the color of their skin, or their parents' income, get the education they will need to succeed.

Although they differed on specifics, during the race for the White House both presidential candidates, Al Gore and George W. Bush, called for additional spending and greater accountability for federal dollars. A consensus about the need for additional investment and the need to use federal dollars to leverage results-based accountability at the local level sets up a potential "grand bargain" on ESEA reauthorization. Such a bargain would couple Democratic demands for greater federal investment in elementary and secondary education with Republican demands for greater local decision-making, all within a new rubric of accountability based on student performance. An arrangement along these lines will force the new

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administration to take on liberals and special interests desiring unlimited expansion of narrowly focused federal programs and micro-management of local school districts. And it will require them to challenge conservative orthodoxy that unadulterated and unaccountable local control of schools will somehow leverage better student performance.

ESEA comprises more than 50 programs and initiatives spread across 14 titles. Historically, the purpose of ESEA was to help ameliorate the gross disparities in educational opportunities by increasing the educational investment for economically disadvantaged students. Over time this focus has been diluted by the addition of a host of other programs large and small. All of the programs embody worthy goals, but the efficacy of a federal program to accomplish or support many of them is questionable. Further, this dilution of purpose has created a statute that is essentially an educational catchall resulting in a fractured federal approach to education reform that lacks an overarching vision or sense of priorities. ESEA is also in many ways a relic of identity politics trophies harking back to an earlier era of Democratic politics and policy. Perhaps most important, narrowly tailored programs, no matter how well-intentioned, necessarily preclude local prerogative and decisionmaking. This obviously doesn't mean that there is no place in federal education policy for small or narrowly focused programs, only that this approach doesn't naturally lend itself to educational challenges because of the nature of our schools and should, hence, be carefully considered.

"Historically, the purpose of ESEA was to help ameliorate the gross disparities in educational opportunities by increasing the investment for economically disadvantaged students. Over time this focus has been diluted by the addition of a host of other programs, large and small."

Annual spending on ESEA is more than $15 billion, and although there is substantial process-based accountability for how federal resources are used, there is woefully little attention paid to the results achieved with these monies. This is not solely a federal problem and the states are also culpable; however, the lack of a results-based focus in federal policy and the fractured purposes of ESEA confuse the issue for state and local officials and further distract from a focus on results. In the words of a senior General Accounting Office (GAO) official testifying before Congress in 1997, "The current situation has created the potential for inefficient service and reduced overall effectiveness."

With more than 14,000 local school districts spread across the 50 states, a top-down, command-and-control approach to ensuring compliance and accountability is impractical. Yet that is essentially the approach that ESEA has taken. The 1994 reforms to ESEA began to emphasize performance, particularly with regard to the Title I program for disadvantaged students; however there is still a great deal of work to be done. A June 2000 report from the GAO found that most states are still not positioned to hold school districts and individual schools accountable for the educational outcomes of economically disadvantaged students. Considering that the achievement gap separating lower income students from their more affluent peers has a pernicious effect, such accountability is essential. For example, according to the Education Trust, a respected nonpartisan group focusing on the needs of disadvantaged students, by age 24, 48 percent of college graduates come from high-income families while only 7 percent come from low-income families. This appalling gap is a direct result of deficiencies in our elementary and secondary education system.

A New Synthesis

In Washington, the debate over how to reauthorize ESEA and assert national leadership to address these problems has essentially broken down along partisan lines into an argument about whether to add more of the same or convert ESEA to a block grant with little or no accountability. In 1999, in an effort to bridge this stale debate, New Democrats introduced a Third Way approach that incorporated the basic ingredients of a grand bargain between the right and left.

The New Democrat bill, the Public Education Reinvestment, Reinvention, and Responsibility Act, (or Three R's bill) was championed in the Senate by New Democratic Sens. Joseph Lieberman (Conn.), Evan Bayh (Ind.), and Mary Landrieu (La.) and in the House by New Democratic Representatives

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Fighting entrenched resistance

The opponents' arguments fall apart under scrutiny

Opponents of the Three R's bill and the performance-based approach will argue that a perverse consequence of the bill will be the abandonment of the purposes and goals embodied in the various ESEA programs without a specific federal initiative or earmark for each one. Critics will also argue that the Three R's bill will jeopardize all of the accomplishments of federal policy over the past 35 years. And some will argue that federal education policy is largely futile because Washington only contributes 7 percent of all elementary and secondary education spending.

All of these arguments fall apart under close scrutiny. For instance, there's no evidence to support the claim that, without direct federal pressure, those who run schools would forsake their commitment to technology, extended learning time, and safe schools that keep out drugs and violence, to name a few key goals. Nonetheless, there are true believers on the Left who fear a world where local officials are empowered to decide among various priorities based on costs and benefits, local needs, and other circumstances unique to a particular locality. For a long time, detractors of America's teachers sought to "teacher-proof" curriculum in schools. Because the teacher is the most important link in the learning chain, this approach predictably failed. Attempts to "administrator-proof" our schools from the federal level will prove to be equally unproductive.

Moreover, the Three R's bill does not preclude additional federal programs and initiatives in education. On the contrary, by addressing what Jonathan Rauch has characterized as "demosclerosis" — the clogging of the arteries of democracy with special interest programs and subsidies — the Three R's opens the door for a more dynamic federal role with new, shorter-term initiatives that address various problems rather than contributing to the calcification that occurs when new programs are simply layered on old.

A secondary argument is that without a host of programs, each supported by an enthusiastic constituency, funding levels for education will drop. But this claim is belied by the numbers: The Three R's bill would authorize more than a doubling of the federal investment in elementary and secondary education. Moreover, this argument is nothing more than a thinly veiled case for the gridlock and paralysis caused by special interest pressure. Despite ebbs and flows in the number of programs, federal support for elementary and secondary education has increased (in constant dollars) from $6.9 billion in 1980 to $17.6 billion in 1999. It is entirely plausible that this increase had little or nothing to do with the number of specific programs but was a reflection of public desire for educational improvement.

The claim that federal education policy is a futile undertaking is spurious. Although the 7 percent figure has taken hold in the public dialogue, it understates the true impact of federal policy. First, because no state wants to lose its federal support, federal dollars are a lever of accountability and performance, just as they were in 1994 with regard to standards. Second, because federal dollars are targeted to disadvantaged communities, they have greater impact than elsewhere. While affluent areas draw a very small part of their revenue from the federal treasury, disadvantaged districts draw much more than 7 percent. This is why Republican efforts to loosen the targeting of federal dollars should be resisted.

Unfortunately, the belief that federal aid is largely futile has a debilitating effect on the educational politics of both Democrats and Republicans. According to this reasoning the primary utility of ESEA

IN THE SCHOOLYARD: Sen. Lieberman campaigns for the Three R's.

is political rather than substantive. Therefore it is considered bad politics for Democrats to eliminate or streamline programs that have successfully been used to browbeat Republicans, regardless of how lackluster their results have been. Similarly, because established education interests in Washington generally fail to support Republican legislative initiatives regardless of their merit, many Republicans have concluded that federal policies are more effective as rallying points for their political base than as instruments of policy. Of course, this is only compounded by the philosophical opposition among some Republicans to a national role in elementary and secondary schooling. The result is a largely dysfunctional dialogue and a lost opportunity to add value to the education reform movement.

The claim that streamlining narrow programs into broader purposes would jeopardize federal education accomplishments is patently false. The Three R's bill will build on the successes over the past 35 years — in access, resources, and standards. It will also modernize the federal role for the realities of the 21st century where equity is measured by educational quality rather than by how dollars are spent or how many programs are created. In addition, the bill would address head-on the primary shortcoming of federal education efforts over the past 35 years, their failure to substantially combat the persistent achievement gap.

— Andrew Rotherham

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"Rather than preserve or buttress the status quo as many Democrats would like, or abandon federal efforts in education altogether along the lines of what many Republicans desire, the Three R's bill is a fundamental redefinition of federal involvement in elementary and secondary education."

Cal Dooley (Calif.) and Adam Smith (Wash.). The Three R's would restructure federal education aid to focus on results rather than inputs. This means that student performance, particularly progress toward closing the achievement gap between minority and economically disadvantaged students and other youngsters, would be the new measure of equity and accountability. The bill is a dramatic break from the old model of focusing on how much money was spent or holding educators accountable for specifics on how dollars were spent rather than on results.

The Three R's bill codified New Democratic education principles in a new approach to federal education policy that would:

- Increase accountability for educational results by making ESEA performance-based and introducing real consequences for performance;
- Increase flexibility within ESEA by streamlining the Byzantine system of more than 50 programs into five performance-based grants to improve flexibility and empower states and localities to make decisions about the best use of federal dollars provided they are achieving demonstrable results; and
- Both double the investment in ESEA and increase the targeting of these resources to ensure that they reach the most distressed communities.

Rather than preserve or buttress the status quo as many Democrats would like, or abandon federal efforts in education altogether along the lines of what many Republicans desire, the Three R's bill is a fundamental redefinition of federal involvement in elementary and secondary education. The Three R's would build on important accomplishments since ESEA was first passed while modernizing the federal role for the challenges of the 21st century. Independent of one another the changes that the Three R's makes to federal policy — greater flexibility, accountability, and investment — are unlikely to change the status quo; however, in concert they represent a new, more robust and dynamic federal role in education.

The Three R's performance-based grants provide for local decisionmaking and local initiative but hold the recipients of federal education aid strictly accountable for improving student performance. Student performance as measured by standardized state assessments is clearly not the only educational outcome society wants from its schools. However, it is the output that the national level of government is best positioned to measure, interpret, and use as a tool of accountability.

Performance-based grants are a break from the traditional liberal approach of unconditional support regardless of results and narrow categorical programs for specific issues. They also contrast with the "blank check" block grants favored by Republicans. Instead, they target federal support to broad purposes of national significance, target it to areas of high needs, and hold recipients accountable for outcomes. Performance-based grants provide local flexibility but within the context of defined results reflecting the purposes for which the funds are provided.

Rather than a myriad of programs and initiatives, under the Three R's bill, the bulk of

GREAT TEACHERS: Performance-based grants would reward the best educators.

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federal dollars would be focused on compensatory education for disadvantaged students, helping limited-English proficient students learn English, improving teacher quality, supporting innovative practices and local initiatives, and expanding choice and competition among public schools.

Educational reforms are taking hold around the country as states and communities experiment with initiatives to raise standards for students, increase teacher quality and recruit new teachers, and increase choice and competition among public schools. The underlying premise of the Three R's bill is that Washington cannot support these dynamic education reform efforts through a statute that is a relic of the top-down bureaucratic approaches of the past and is calcified because of interest group and identity politics rather than attention to the needs of children and the schools and school districts that serve them. The changes in education at the state and local level are happening at a pace that makes it impossible for narrow categorical programs and traditional bureaucracies to adapt. As a result they become a hindrance to reform rather than an empowering presence.

The Three R's bill has drawn praise from groups on the left and the right and has been endorsed by New Democratic governors. In addition, reform-oriented local educators praised the bill. At a hearing on the Three R's, Seattle Superintendent Joe Olchefske, generally considered a leading reformer, said that the bill would help him do his job more effectively than the current arrangements. Perhaps most important, support for provisions of the Three R's bill was bipartisan in the race for the White House. Vice President Gore included much of the Three R's approach to accountability in his agenda, and Governor Bush included the basic architecture of the Three R's as part of his plans to reform federal policy. Let's hope this foreshadows a new consensus on education in Washington. However, even in the face of this emerging consensus in 1999, some Democrats in the Senate couldn't bring themselves to support many of the bill's provisions, in large part because they were opposed by interest groups in Washington, and Republicans decided that doing nothing on education was preferable to sending President Clinton an education bill in an election year. On both counts, politics soundly trumped the emerging policy consensus.

To demonstrate the seriousness of its commitment to educational improvement, the new administration must overcome parochial politics and act expeditiously to use the Three R's bill as the basis of bipartisan action on education. While it isn't a panacea for what ails our schools and doesn't mean that other federal initiatives are not needed, the Three R's bill is a powerful synthesis of the best ideas of the left and the right and the best way to put Washington in the position of leading on education and supporting states and localities rather than idly playing politics — or worse, getting in the way of reform.

Time to Move Forward

At the national level, the debate about how to address education has broken down along predictable and partisan lines. Republicans still call for block grants with little or no accountability and Democrats for the most part continue to argue that the solution to the educational woes of disadvantaged students will be found solely through more programs and funding. Unfortunately, neither of these approaches will address key educational challenges in a meaningful way and improve the federal role to meet its historic commitment of equal educational opportunity. Instead, they will ensure that federal education policy remains a political battlefield rather than a constructive and positive presence on the educational landscape.

The new administration has a chance to either re-fight these same tired battles with regard to education or forge ahead with a new consensus that puts Washington in its rightful place as a catalyst for success and innovation. Let's hope they will be able to use the Three R's bill, a truly progressive approach to elementary and secondary education policy, to find a middle ground with Congress that puts the needs of children ahead of those of adults and ushers in a new era of more constructive federal involvement in education. ■

"The underlying premise of the Three R's bill is that Washington cannot support these dynamic education reform efforts through a statute that is a relic of the top-down bureaucratic approaches of the past."

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3 A new Medicare for the New Economy

The boomers are coming. It's time to modernize the system.

by Jeff Lemieux

Although you wouldn't know it from last year's campaign rhetoric, most Democrats and Republicans in Washington now agree on a basic approach to Medicare reform and on the need to expand the program's benefits, especially for prescription drugs. This year, the new administration should rise above the usual partisanship, offer to share credit with its political opponents, and close the deal for a durable new Medicare.

To finish the job, we must expand benefits *and* create a new, market-based approach to how Medicare actually delivers benefits. The solution must address the program's four big problems:

1) Medicare's fee-for-service benefits are inflexible and out of date. Most seniors face large out-of-pocket costs for prescription drugs and other items not covered by the traditional fee-for-service program; many purchase additional insurance to fill in the gaps in Medicare's benefits, sometimes at great expense.

2) Medicare's system for HMOs is on the verge of collapse. About 1 in 6 Medicare beneficiaries has joined an HMO to get better benefits and avoid high out-of-pocket costs. But Medicare's system for HMOs is similar to its administration of the fee-for-service program: a bewildering array of government-set prices and a dense thicket of regulations. Faced with lower reimbursements and higher costs, many HMOs are slashing benefits or dropping Medicare participation altogether.

3) Medicare's fee-setting and regulatory approaches are inefficient and stifle innovation. Medicare's inadequate fee-for-service program and its dysfunctional system for HMOs are not the result of

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KILLER COSTS: Prescription drugs can be prohibitively expensive for some seniors. A drug benefit should aid those who need it without overburdening the taxpayers.

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"Old Medicare was not designed for modern benefits or competitive approaches, just like the average 1960s-era car was not designed for modern features like air bags or fuel injection."

bureaucratic ineptitude or bad motives. They are the inevitable and direct result of how Medicare is structured. The way Medicare currently works, Congress is required to dictate virtually all of Medicare's fees and rules. The Department of Health and Human Services (HHS), which administers Medicare, adds layer upon layer of regulations in an increasingly futile attempt to apply those fees and rules to a fluid, constantly changing health sector.

4) Medicare's costs will mushroom when the baby boomers retire. The backdrop for any Medicare reforms, including adding needed (but expensive) new benefits, is the fact that as 70 million baby boomers retire, high Medicare spending is likely to crowd out other government initiatives, prompting a return to deficits, or forcing tax increases. Without reform, Medicare spending could easily jump from more than 10 percent of the federal budget today to 30 percent of the budget by 2030. Combined with Social Security and Medicaid (a program for the poor, including many elderly people in nursing homes), the total cost of entitlement programs for the baby boomers could starve other important functions — such as education, research, even defense.

The first two problems — inadequate benefits and insufficient choices — directly hurt seniors. Seniors are less concerned about the third problem — Medicare's administrative inefficiency and structural obsolescence — though it is the root cause of the first two. Furthermore, Medicare's internal inefficiency contributes to its high costs, which should never be far from policymakers' minds.

The bottom line is that Medicare's creaky internal workings are no longer politically acceptable. Medicare was designed in the 1960s, yet its benefits have not kept up with medical advances and seniors' needs precisely because of its top-down government controls and old-fashioned administration. Old Medicare is like an old car: powerful, but inefficient and always in need of maintenance. Old Medicare was not designed for modern benefits or competitive approaches, just like the average 1960s-era car was not designed for modern features like air bags or fuel injection or state-of-the-art emissions controls.

The good news is that during the 2000 presidential campaign, both candidates agreed on steps to build a new Medicare that would give more power to seniors, not bureaucrats. On the campaign trail, Al Gore stressed prescription drugs and George W. Bush emphasized reform. But beneath the rhetoric both candidates proposed to combine new benefits like prescription drugs with a new competitive system that would make the program more modern, flexible, and efficient.

Yet while the candidates agreed on the fundamentals, their campaigns — as well as those in Congress — focused on the remaining differences between the reform plans, not on their abundant similarities. If a deal is to be made, Republicans cannot back away from improved benefits in Medicare. Short-term political expedients, like granting funds to the states to aid only the neediest seniors, will not suffice. For their part, Democrats — historically the guardians of Medicare — must resist the temptation to sidestep systemic reforms and just pump money into expanded benefits under the old program. Perpetuating the old system will turn into a political loser very quickly if its benefits disappoint or its costs explode. To maintain strong political support from all its stakeholders, including beneficiaries, taxpayers, and health care providers, we should retool Medicare for the vibrant New Economy of the new century.

The New Economy is based on research and innovation; information and empowerment; market forces; and self-adapting, self-improving, non-hierarchical organizations. Workers are being empowered to greatly improve their productivity. Well-informed consumers have gotten used to better products at lower prices. In the future, seniors and taxpayers alike, accustomed to the efficiency and transparency of other sectors of the New Economy, will demand more value from Medicare as well, including better benefits, more choices, and competitive premiums. Looking out into the future, the old Medicare program will not be capable of delivering that value. It must change.

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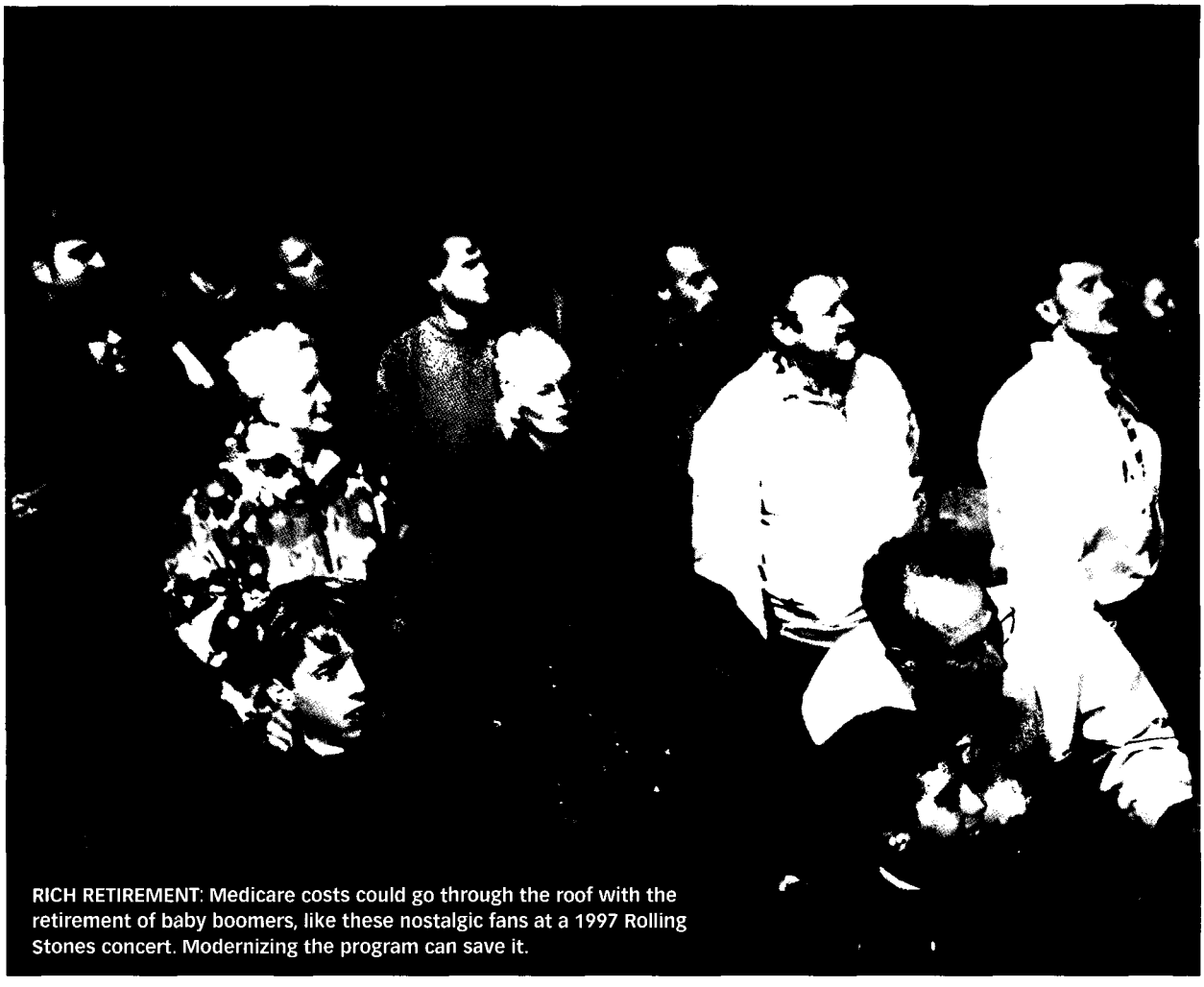

RICH RETIREMENT: Medicare costs could go through the roof with the retirement of baby boomers, like these nostalgic fans at a 1997 Rolling Stones concert. Modernizing the program can save it.

As with other sectors of the New Economy, vigorous and open competition will be key to spurring innovation and enhancing Medicare's value to seniors and taxpayers. Here are the major elements of a New Medicare for the New Economy:

• **Competition.** Medicare needs a new style of competition patterned after the Federal Employees Health Benefits (FEHB) program to expand and stabilize seniors' choices and to temper Medicare's future costs.

• **Modern benefits.** We should add prescription drug benefits and new limits on seniors' out-of-pocket costs; we should subsidize those new benefits sufficiently to encourage most seniors to enroll.

• **A new attitude and process.** We must change the culture of Medicare first by establishing a new executive agency outside of HHS that is familiar with competitive systems to oversee the new competitive approach. (For discussion purposes, we call this new entity the Medicare Agency below). Second, we must hammer out a new process under which HHS has the flexibility to make the traditional fee-for-service program more modern and accountable.

• **Innovation and choice for drug benefits for fee-for-service enrollees.** The new Medicare Agency should have the power and financial flexibility to guarantee that seniors enrolled in Medicare's traditional fee-for-service program will have access to choices of affordable private coverage for prescription drugs and other out-of-pocket costs. The Medicare Agency must create a market for private coverage and must not dictate prices and detailed coverage rules.

"Vigorous and open competition will be key to spurring innovation and enhancing Medicare's value."

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"Breaux's most recent proposal has sparked interest among centrist Democrats and moderate Republicans, and it was endorsed, at least in general terms, by candidate Bush during the campaign."

Almost There: The Path to Medicare Reform

Comprehensive Medicare modernization is a relatively new idea. In 1998, a bipartisan commission co-chaired by Sen. John Breaux (D-La.) and Rep. Bill Thomas (R-Calif.) produced a plan to remodel Medicare based on the federal employees' system of choices and competing health plans. In addition to the new competitive system, the plan added benefits for prescription drugs and limited beneficiaries' out-of-pocket costs for hospital and physician services. To save money, however, the Commission's plan would have raised Medicare's eligibility age and added some new beneficiary copayments. Furthermore, it subsidized prescription drug benefits only for beneficiaries under or just above the poverty line.

However, the Medicare Commission didn't account for the rapidly improving budget outlook in Washington, and its plan did not spark the hoped-for political consensus. As budget deficits switched to surpluses in 1998 and 1999, President Clinton and many in Congress refused to embrace such penny-pinching measures.

In June 1999, the Clinton administration countered with its own reform proposal. Clinton's proposal also embraced the FEHB as a model for competition, but it added measures to protect traditional fee-for-service from the full force of market prices. In so doing, it allowed the new competitive system to save beneficiaries money, but limited the amount the government would save. The Clinton plan also dropped the section that would raise the eligibility age. Finally, the Clinton plan generously subsidized prescription drug benefits for all seniors and formed the new drug benefit on the traditional fee-for-service model, with the government poised to dictate payment policies and rates.

Seeing an opening, Senator Breaux started working toward a compromise. His most recent proposal, cosponsored by Sen. Bill Frist (R-Tenn.), also drops the increased eligibility age, accepts Clinton's milder form of competition as an interim step, and raises the subsidies for drugs to almost three-quarters of Clinton's proposed level. Unlike Clinton's approach, however, Breaux's plan creates a market for prescription drugs, so that Medicare beneficiaries in the fee-for-service program would have a choice of drug plans, and so the Congress would be more removed from the setting of drug prices and fees.

Finding the Compromise

Clinton's plan was essentially adopted by candidate Gore, and it is supported by many Democrats. Breaux's most recent proposal has sparked interest among centrist Democrats and moderate Republicans, and it was endorsed, at least in general terms, by candidate Bush during the campaign.

Since the two sides are already very close, any remaining disputes over formulas for competition and subsidies for new benefits should be easy to resolve. However, sticking points remain on how the new competition and benefits will be administered. Gore wants the competition to be administered by HHS, while Breaux prefers a new agency. On that point Breaux is right. The only way to resolve the most crucial outstanding issue — ensuring that fee-for-service enrollees will have access to drug benefits — is to create a new executive agency to oversee the new Medicare marketplace.

Here's the problem: market solutions for drug benefits are a much better idea than the sort of rigid price controls that have distorted and politicized the hospital industry and other sectors of the health economy. But how do we ensure that solid markets will spring into existence and that all seniors — including those in the fee-for-service program — will have good choices? By definition, free markets are impossible to predict.

The Gore plan approved of market solutions for HMOs and other comprehensive health plans, but implied that markets couldn't be made to work for drug benefits in the fee-for-service program. That's why it put HHS in charge of the benefit. Government control is the only way to be sure the benefit will be there for all beneficiaries, Gore maintained.

Senator Breaux's plan relies on a new Medicare agency to run the program's market

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systems, both for comprehensive plans and for extra benefits for fee-for-service beneficiaries. He would create a mini-market of plans specializing in drug and other extra benefits, and seniors would be able to pick from those plans based on price and benefit levels. Markets are the only way to ensure continuing innovation, efficiency, and dynamism in the health industry, Breaux argues.

In general, Old Democrats prefer Gore's drug proposal, with its large subsidies and de facto government control of drug prices and fees. In those respects, Gore's proposal represents the classic Medicare entitlement, with the same benefits available to all seniors and provided under strict government dictate. Old Democrats like to say their drug benefit is "in Medicare," meaning that it would operate just like the other parts of Medicare's fee-for-service program.

New Democrats like Senator Breaux would add a drug benefit to Medicare, but only in the context of market competition and choice, not direct government management. Breaux believes HHS has distinct bureaucratic objectives — such as protecting the fee-for-service plan from competition and enlarging its empire of price controls and regulations — that could thwart market solutions to the drug question.

Fortunately, there is a bridge between the two approaches. Senator Breaux is right to prefer competition to an HHS-administered program, but Gore was right that full government authority is the only way to be absolutely sure a benefit will be there for all seniors.

The essential compromise is clear: allow the government sweeping authority to ensure drug benefits are available under any circumstance, but give that authority to a new government agency that knows how to work with market systems and private companies, not to HHS, which only knows price controls and regulations. Breaux's plan should be more explicit about exactly what tools the Medicare Agency could use to ensure that drug benefits would be available even if markets were slow to form. The Medicare Agency should be given full authority to share risk with private companies as markets develop, but it should be structured so that any direct government provision of drug benefits would be temporary — a true last resort, not a first option. New Democrats must be confident that the new Medicare Agency is completely committed to market solutions, not to creeping bureaucracy and regulations

BIPARTISAN BACKING: The duo of Sen. John Breaux (D-La.), above, and Sen. Bill Frist (R-Tenn.), inset, have put forward a Medicare reform plan with broad political appeal.

Conclusion

The right mix of Medicare benefit expansions and competitive reforms requires the best of both strong government oversight and flexible private markets. Conservatives must agree to protect the fee-for-service program for a time, allow the new Medicare Agency a great deal of latitude in creating a market for drug benefits in fee-for-service, and support higher subsidies for drugs. Liberals must acknowledge that the HHS is not suited to run competitive systems, that market approaches must be the goal for drug benefits, and that costs cannot be allowed to get out of hand.

The political partnership for that sort of deal is shaky, but it does exist. By improving benefits, we can help America's seniors now. By using market forces and competition to shore up Medicare's creaky inner workings, we can assure seniors that we will be able to afford excellent health benefits in Medicare for their children and grandchildren as well. ■

"The right mix of Medicare benefit expansions and competitive reforms requires the best of both strong government oversight and flexible private markets."

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Covering the uninsured

Ways to make health insurance available and affordable to 43 million Americans

by David Kendall, Jeff Lemieux, and S. Robert Levine, MD

The health care issues debated in the 2000 presidential race focused mostly on prescription drugs for older Americans and HMO regulation. Both issues involve improving health insurance for people who already have it. But 43 million Americans have no coverage at all; their plight is far more pressing and must be addressed immediately.

The American public consistently ranks the problem of the uninsured in our society as a top national health problem. Americans are concerned for others as well as for themselves. While most of the uninsured are lower-income workers and their families, we all recognize that any of us, under certain circumstances, could fall into the ranks of the uninsured. Clearly, health insurance is no sure bet in our society.

Two developments make this a ripe moment for the new administration to launch a major initiative that would make health insurance more affordable and available to more Americans. One is our big budget surplus; the other is a growing bipartisan consensus around an approach that expands public subsidies for private insurance.

Unlike in the 1980s and 1990s when the high budget deficits drove policymaking, today's budget surplus makes it possible to expand coverage to the uninsured without increasing taxes on those who have insurance. What's more, letting uninsured taxpayers use some of the surplus to get coverage is only fair. Most insured taxpayers receive a generous tax break because health care benefits received on the job are tax-free.

A health insurance tax credit can prevail over the ideological gridlock that has shut down past efforts to achieve universal coverage. It was one of the campaign promises of then-Governor Bush and Vice President Gore. It combines the left's push for public financing with the right's preference for private coverage. Indeed, it has won support from members of Congress as politically diverse as House Majority Leader

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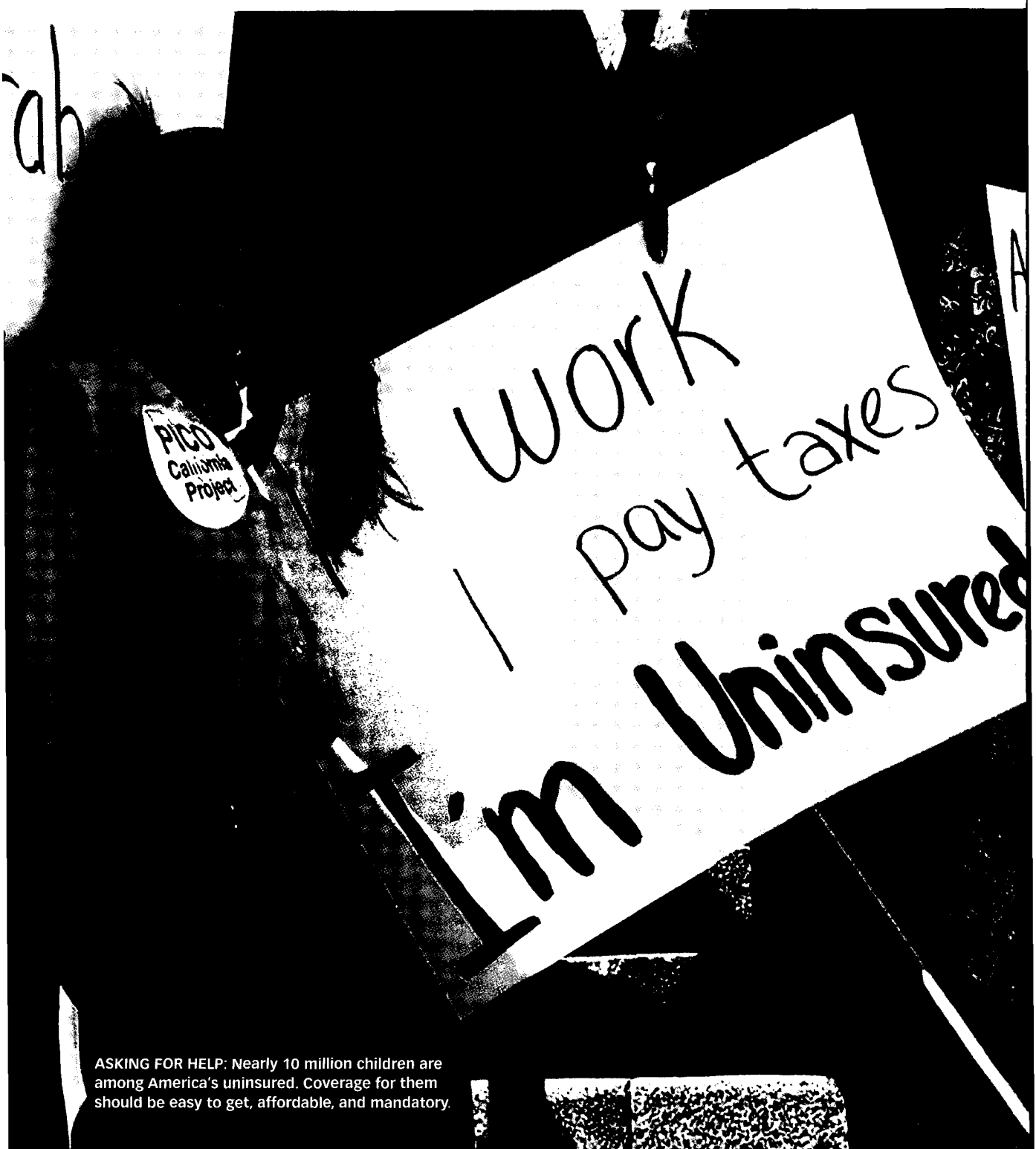

ASKING FOR HELP: Nearly 10 million children are among America's uninsured. Coverage for them should be easy to get, affordable, and mandatory.

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"The stage is set for the president to offer a new vision for health care in our nation."

Richard Armey (R-Texas), a conservative, and Rep. Pete Stark (D-Calif.), a liberal who supports a Canadian-style, single-payer health care system. It has also been advanced by the conservative Heritage Foundation and the centrist Progressive Policy Institute.

With these political realities in alignment, the stage is set for the president to offer a new vision for health care in our nation. Rather than being offered a government-run system or a fend-for-yourself marketplace, consumers should be empowered, with government help, to take charge of their own care. Consumers need to become the purchasers of health care so that doctors, hospitals, and insurance companies are responsive to their needs. But they will not be successful without the support of people, institutions, and information they can trust to help them make important decisions. Consumers also need new tools like the Internet to connect them to the people and resources that can improve their health (for details, see BLUEPRINT, Vol. 6, Spring 2000).

Covering the uninsured is the ideal issue for pursuing a new vision for health care. Unlike in debates over prescription drugs and HMO reform, the battle lines have not been drawn, and the public is ready for a fresh approach. The proposal outlined below uses government financing and oversight to ensure affordability and access, but it relies on private markets and

THE WALKING WELL: Many young people, like this bartender in Pennsylvania, work at low-wage jobs that do not provide health insurance. That's another reason to mandate universal coverage.

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competition to spark innovation and restrain costs. It builds on the existing job-based health insurance system while compensating for its weaknesses. Finally, it makes it clear that the ultimate responsibility for health insurance rests with every individual and family.

The Policy Challenge: Making Tax Credits Work

While a health insurance tax credit provides a solid foundation for reform, it is not by itself enough to substantially reduce the ranks of the uninsured; it is simply a way of making coverage more affordable. It does not ensure that people will be able to buy insurance. Anyone who has tried to get health insurance outside a job knows how difficult that can be. One problem is that the private marketplace routinely denies coverage or charges very high premiums to people with high health care costs.

To overcome these obstacles to coverage, we propose a four-part approach it includes: tax credits that can be readily used to buy coverage through a job or elsewhere; purchasing groups to make a choice of health plans widely available; grants to states so they can help create an equal opportunity for everyone to get health insurance; and individual responsibility for coverage once it is affordable and available.

1) Tax credits. The tax credit would let employees buy coverage through their workplace even if their employers did not offer coverage. Employers would be responsible for making the adjustments in a worker's paycheck. They would also send a check to the insurance company to pay the premiums. To offset these administrative costs, employers would also get a tax break.

The health insurance tax credit would be worth $2,500 for families and $1,000 for individuals. If their employer did offer coverage, then workers would be eligible for a smaller credit that would make their share of premiums more affordable. This smaller credit would be $1,000 for families and $400 for individuals.

Low- to middle-income taxpayers would be eligible for the credit. Very-low-income workers would be eligible for the credit even if they did not pay any income taxes (they would receive a refundable credit on their payroll taxes, similar to the Earned Income Tax Credit). Higher income taxpayers would remain eligible for the existing tax breaks for health insurance received through a job or as a self-employed worker.

To understand why a health insurance tax credit would induce more people to get coverage, it's important to know how federal tax policy already encourages people to get health coverage through their jobs. Employees receive a nearly invisible tax break because when employers pay for coverage on behalf of their employees, the cost of insurance is not treated as income and therefore not taxed. That gives employers a strong reason to offer health insurance in lieu of wages. In effect, this tax break is a subsidy for job-based coverage. It reduces the annual cost of insurance by approximately $1,500 for families and $600 for individuals in low- to middle-income tax brackets. At that level of subsidy, about half these families and individuals have taken up job-based coverage. So there's a good reason to believe that substantially increasing this subsidy would induce many more people to get coverage.

It would be unfair, however, to provide a new tax credit for the uninsured if workers with similar means who were struggling to afford insurance became worse off. That is why the proposed smaller tax credit ($1,000/$400) for employees with job-based coverage is so important. For them, it would be a tax cut because they are already paying for coverage through their employers. Without it, employers with low- to-middle-income employees would likely drop their coverage so their employees could take advantage of the larger tax credit (a $2,500 tax credit vs. a $1,500 tax subsidy for families). The smaller credit is doubly important because it would make coverage more affordable for employees who must pay a significant share of the insurance premium. (About 9 million individuals are offered coverage at work but do not take it.)

2) Purchasing groups. To select a health plan, employees would receive a menu of

"Anyone who has tried to get health insurance outside a job knows how difficult that can be. The private marketplace routinely denies coverage to people with high health care costs."

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options similar to the Federal Employees Health Benefits (FEHB) program. These are outlined in a pamphlet given to federal employees every year that compares the prices and benefits of various insurance options in the state where they live. The menu would be generated by either a purchasing group that the employer has joined or by the state insurance commissioner based on generally available insurance plans.

Purchasing groups give employees more choices than most employers offer. For example, the FEHB offers as many as 20 choices to its 9 million members.

Under our proposal, the use of a purchasing group would be voluntary. But as a condition of receiving new grants described below, states would be required to make at least one such group available to individuals and small businesses. In some states, like California, small employers already have a choice of competing purchasing groups.

3) State grants. Because health insurance markets are local and regulated in different ways by every state, creating a one-size-fits-all federal policy would be politically difficult. Instead, every state should receive a federal grant to be used to make its local insurance market more fair. Innovative ways should be sought to compensate for the fact that insurance companies charge higher premiums to the aged and sick who have higher health care costs. About $5 billion a year would be set aside for grants to the states. Up to half the funds should be dispersed as performance incentives — based on measured improvements in coverage rates, access to basic health services by lower-income citizens, and (when feasible) measures of health outcomes. Thus, over time, the grants would reward states that use these funds effectively to improve the health insurance coverage and health of their populations.

Experimentation and innovation should be encouraged. The states could use their grants in various ways. They could, for instance, subsidize purchasing groups that are open to everyone regardless of their health condition, provide subsidies directly to high risk individuals or their insurers as a supplement to the tax credit, or create special purchasing pools devoted to people with high health risks. In addition, states could use some of their money to provide basic and preventive health services, aimed in part at lower-income individuals who remain uninsured for whatever reason.

4) Individual responsibility. The new tax credits for family coverage, combined with the current government programs for children, should eliminate any excuse for allowing children to go without health care coverage (10 million of the uninsured are children). Health care insurance for children should be federally mandated, and parents should be made responsible for getting coverage for their children within three years after passage of our plan. The penalty for not having coverage would be assessed every April 15: the loss of the personal exemption for children on the parents' income tax return.

"Health care insurance for children should be federally mandated, and parents should be made responsible for getting coverage for their children within three years after passage of our plan."

For adults, it is not clear whether the tax credits and state grants will be enough to make health insurance universally affordable and available. Thus, five years after our proposed tax credits and other reforms went into effect, Congress and the administration would appoint a commission to study the impact of the credits and recommend changes. Perhaps the most important question, as a way of finally achieving universal coverage, would be whether or not to penalize adults on their tax returns if they did not have coverage for themselves, just as we would do for not covering children.

The Political Challenge: Governing From the Center

Covering the uninsured presents many political pitfalls that the new president can avoid by steering a centrist course. The two extremes in the political debate hold views that will lead to failure because they threaten the coverage that Americans receive through their jobs. Many liberals would replace the job-based system with a Canadian-style, single-payer system. Many conservatives would replace job-based coverage with individually purchased policies. Our plan builds on job-based coverage while compensating for its shortcomings.

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A single-payer system creates a one-size-fits-all government entitlement. The government acts as the sole insurance company, so people would have even less choice about their health plans than they do under today's job-based system. With a system of no choice and thus no competition, the government would set prices and determine who got what health care services. In contrast, a market-based system would restrain costs and allocate resources based on the decisions of individuals.

A marketplace based on individually purchased health insurance avoids the problems of a single-payer system but has its own problems. About 15 million Americans are now covered through individual policies, but few experts would hold this up as a model of efficiency and equity. Insurance companies are inherently suspicious of individual purchasers because some people wait until they get sick before trying to buy insurance. As a result, insurers must conduct expensive reviews of applicants to weed out people who are in effect trying to insure a burning house.

FREE CARE: Too many citizens, like this boy in a Mississippi mobile clinic, are dependent on public facilities for their basic health care.

Our approach avoids these pitfalls by building on the success of the private insurance market offered through the job-based system. For example, by offering coverage to workers once a year at a job, insurers don't have to worry as much about whether individuals are trying to buy insurance only when they need it. To the extent that some people might still game the system, our plan would give states new funds to cover any extra costs they might incur. To expand choice in the current job-based system, our plan also encourages the use of purchasing groups that offer a variety of health plans. Finally, our plan avoids a mandate that employers pay for coverage, an approach that is based on the myth that employers don't ultimately take the cost of benefits out of workers' paychecks.

A Third Way

Rather than relying on bureaucrats or letting individuals fend for themselves, our proposal gives consumers the tools they need to take control of their health care: enhanced purchasing power, more choices, and personal responsibility. Tax credits would give consumers personal buying power. Purchasing groups and state grants would give them choices and information to make the right decisions for themselves. And by moving toward a requirement that everyone have insurance, our nation would be on a course toward enabling everyone to take final responsibility for his or her own coverage. ▣

"Rather than relying on bureaucrats or letting individuals fend for themselves, our proposal gives consumers the tools they need to take control of their health care."

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Retirement Savings Accounts will increase nest eggs for tomorrow's seniors.

Saving for retirement

Using tax credits to boost private savings.

by Jeff Lemieux

Since the early 1990s, the U.S. economy has performed like a superstar: wages up, poverty down, millions of good jobs created. So why not have a party? Why not cut taxes in a big way, and spend the budget surplus now? Because we know for sure that 70 million baby boomers will soon retire, dropping out of the work force and onto the entitlement rolls.

That's why America should put off consuming the budget surplus and instead harness tax cuts for a higher national purpose: savings. By boosting savings instead of increasing our current consumption, we will be better able to afford our much larger consumption needs when the baby boomers retire.

What does it mean to consume or save a budget surplus? It's analogous to a family's decision to spend an extra dollar (consumption), or to invest it instead (savings). A dollar consumed is gone, but you get something for it now. A dollar saved gets you nothing now, but it earns an investment return so that you have more later. Sacrificing consumption now allows families (and nations) to consume more in the future.

Most taxpayers seem to understand the importance of savings and investment in the New Economy. But many do not trust Congress to save the surplus. If the economy stays hot and the budget surpluses mount, public pressure will build to "give the surplus back," especially through tax cuts. We know that saving the surplus — and thereby paying down the national debt — is the best way to propel the economy now and to prepare for the boomer fiscal crunch. We also know that with the economy already at full employment, cutting personal income taxes could reduce national savings, weaken the economy, and hurt our ability to finance the boomers' retirement. But what if tax cut fever proves impossible to resist?

There is a way to have tax cuts and savings too. It is by choosing tax cuts that are specifically designed to boost private savings. Tax cuts that succeeded in stimulating an equivalent rise in overall private savings would have roughly the same economic impact as paying down the public debt.

Public Savings vs. Private Savings

National savings are the sum of public savings (the surplus) and private savings. By holding off on huge tax cuts or new spending programs, we would allow the budget surpluses (public savings) to build, which would automatically pay down the national debt. That, in turn, would help keep interest rates low and spur the economy. Faster growth and lower debt would put the country in a better position to pay for increased spending, or to keep taxes down, in the future.

On the other hand, all tax cuts or new spending programs directly reduce the surplus, and therefore reduce our public savings. When taxes are cut, people receive the money, and spend most of it. Similarly, when we raise government spending (on things like national defense or prescription drug benefits in Medicare), somebody receives the money directly or indirectly (employees and stockholders of defense contractors and their suppliers, senior citizens and health care providers, and so on). Again, most of the money gets spent. Private savings might go up a little, but most income tax cuts or new spending programs would not raise private savings by enough to compensate for the loss of public savings. In net, national savings would fall, causing interest rates to rise and private investment to slow.

Tax Cuts That Boost Private Savings

Over the last few years, three major tax cut ideas have emerged on the political scene that would significantly boost private savings, not consumption. One is the Retirement Savings Account plan espoused by Al Gore during the 2000 presidential campaign, under which the government would match the retirement savings of low- and middle-income families. Another is the payroll tax carve-out plan proposed during the campaign by George W. Bush, which would shunt 2 percent of payroll taxes to personal retirement accounts as part of a package of Social Security reforms. The third is the KidSave proposal put forward by former Sen. Bob Kerrey (D-Neb.), which would fund a modest retirement account for all children. Each plan would reduce public savings, of course, but they would mostly offset that reduction by transferring public funds to private savings accounts.

To understand the three plans — as outlined below — it is important to know

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that new incentives for certain types of savings sometimes just cause investors, especially wealthy ones, to switch their portfolios around to take advantage of the incentives rather than add to their overall savings. However, for various reasons people would be less likely to react to these new savings proposals by making portfolio adjustments. In each of the plans, overall private savings would be significantly increased.

Gore's Retirement Savings Proposal

On the campaign trail, Vice President Gore adopted a classic New Democrat proposal as his signature tax cut: a refundable tax credit for Retirement Savings Accounts (RSAs), which would give generous matching funds to individuals who saved certain amounts. The matching funds would be means-tested, with higher matching rates for lower-income workers' savings than for those with higher incomes. For example, for couples earning $30,000 a year, each spouse could save $500 and receive a government match of $1,500. Couples earning $60,000 could save $1,000 each and receive a match of $1,000 per spouse. Couples earning $90,000 could save $1,500 each and would receive a match of $500 per spouse.

RSAs as proposed by Gore would directly shift public savings (the surplus) to private savings (people's retirement accounts), and could induce some new private savings as well. To get matching funds, people would have to put up savings of their own. Of course, some people would shift savings from other sources to take advantage of the match, but for others, the matching funds would induce them to defer consumption and make new investments. Incentives for savings may not always induce new savings for the rich, but they do induce new savings for lower-income people, and the RSA proposal targets funds to low- and middle-income savers. Therefore, the RSA plan would almost certainly boost private savings by at least as much as the tax cut.

Bush's Payroll Tax Proposal

Unlike Gore's matching formula, Bush's proposal would automatically grant to workers' personal retirement accounts 2 percent of their earnings (up to annual earnings of about $75,000) as part of a package of Social Security reforms. That implies a maximum annual grant of about $1,500 (2 percent of $75,000) each year in a worker's account. In the lexicon of Social Security reform, Bush's proposal is called a payroll tax carveout.

Bush's plan (which was originally proposed by various bipartisan groups in Congress) would probably boost private savings by nearly the full amount placed in the accounts, especially if people believed their accounts were intended to substitute for Social Security benefits. The bipartisan proposals to reform Social Security also include reductions in regular benefits for future retirees, especially for higher-wage workers. Therefore, high-wage workers would be unlikely to view the new accounts as a windfall to be "spent" via reductions in other savings. The new accounts would be a windfall to lower-wage workers, however, since the bipartisan plans would not reduce (and in some cases would increase) future benefits for the lowest-paid workers. However, lower-income workers are the least likely to save anyway, and it seems unlikely that money placed in their new accounts would cause them to reduce their other retirement savings by large amounts. In the context of Social Security reform, Bush's proposal would probably boost private savings by almost as much as it reduced the surplus.

Kerrey's KidSave Proposal

Kerrey's KidSave proposal would grant each child $2,000 at birth. In his latest proposal, the original $2,000 stake (adjusted for inflation) would be repaid when the child reached adulthood. The remainder, representing the compounded investment returns over 30 years, would then be left to grow until the account holder reached retirement age.

KidSave would give every child a measure of financial wealth and a stake in the national economy. As with the payroll tax carve-out, some families would consider their children's accounts as newfound wealth, and, feeling richer, would consume more than otherwise. Similarly, some adults, seeing the money in their accounts grow since childhood, might save less for retirement through other means. But since the accounts could not be tapped until retirement, most people, especially those with modest incomes, would not change their plans for consumption and savings very much. Overall, KidSave would probably boost private savings by a considerable amount, and national savings, therefore, would largely be maintained.

On balance, the Retirement Savings Account plan proposed by Gore would be most likely to spur enough new private savings to fully balance the reduction in the surplus. But Bush's payroll tax carve-out (coupled with some Social Security reforms) and Kerrey's KidSave proposal would also create considerable new private savings. Any of the three proposals would be economically preferable to ordinary tax cuts that flowed straight through to higher current consumption.

The Clinton administration's success in holding off huge tax cuts and new national consumption was a good first step toward preparing for baby boom retirement. Now, faced with a growing urge to give the surplus back, Congress and the new administration should design innovative tax cuts that support savings, investment, and growth, and also boost critical retirement assets for all workers. That will keep the economic party going and make the baby boom headache much easier to bear.

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Making work pay

Welfare reform helped people get jobs.
Now we need to make sure they can earn a living from their work.

by Will Marshall

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WELFARE TO WORK: Millions of Americans, like these two men in a printing firm in Rochester, N.Y., have left the welfare rolls for new training and jobs.

Of all the New Democrat reforms launched during the last decade, none was bolder or more far-reaching than replacing welfare with work. To complete this unfinished revolution in social policy, the new administration must intensify efforts to help people move off the welfare rolls and out of poverty. The president should challenge Congress to make a simple but powerful proposition the touchstone of our 21st century social policy: No American family with a full-time worker will live in poverty.

In the 1990s, President Clinton crystallized public disenchantment with public assistance by vowing to "end welfare as we know it." In the 2000s, the organizing principle of U.S. social policy should be "making work pay" ensuring that through a combination of private wages and public supports all families can lift themselves out of poverty.

Will Marshall is president of the Progressive Policy Institute.

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Welfare reform: A progress report

America's great welfare-to-work experiment is far from finished, but the early returns are nonetheless striking. The nation's welfare caseload, after peaking in 1993 at 14.1 million recipients, has now fallen nearly 60 percent to 5.8 million recipients. The proportion of the U.S. population on welfare is down to 2.1 percent, the lowest in 37 years.

Studies of welfare "leavers" show that most adults who exit the rolls find jobs. The Urban Institute estimates that 61 percent of leavers are working; state studies suggest a range of 50 percent to 70 percent. Those who work full-time earn from $6 to $8 per hour. Employment among poor single mothers with children has risen from 35 percent in 1992 to 51 percent in 1998.

What of the hefty chunk of leavers who don't have jobs? The research yields no clear picture of what has happened to them. Some probably work intermittently, on and off the books. Others may get benefits from other federal programs such as Social Security disability insurance or Supplemental Security Income (SSI). Many seem to be falling back on friends and relatives for support.

Even when families leave welfare for full-time work, they aren't necessarily better off. The number of people receiving food stamps and Medicaid services has fallen along with the welfare rolls, suggesting that many leavers also are losing valuable non-cash benefits. Citing this trend, as well as anecdotes about swollen lines at homeless shelters and food banks, advocacy groups charge that welfare reform has made some families worse off. This is undoubtedly true, though it bolsters the case for a comprehensive system of public supports for working families rather than for weakening work requirements or restoring the old welfare entitlement.

Why Are Welfare Rolls Shrinking?

Most analysts agree that the main factors behind the caseload decline are a strong economy, which has drawn millions of low-skill workers into low-wage jobs; welfare reform itself, which has sent a powerful signal to poor Americans that public assistance is temporary and conditional; and increased support for the working poor, which has made work in entry-level jobs more attractive.

The American Enterprise Institute's Doug Besharov and Peter Germanis synthesized the results of a raft of econometric studies that weigh the contributions of various factors to the caseload decline. They concluded that:

- The strong economy accounts for 15 percent to 25 percent of the decline;
- Welfare reform for 30 percent to 45 percent;
- Aid to working poor for 30 percent to 45 percent; and
- The minimum wage increase for 0 percent to 5 percent.

These findings confound the conventional, left-right wisdom. First, welfare reform — time limits, efforts to "divert" people from welfare, work requirements and the credible threat of sanctions for those who refuse to seek work — has had a much bigger impact on declining caseloads than the robust economy. This is good news, since it suggests that a downturn would not necessarily take us all the way back to square one, as some welfare reform skeptics have predicted. Second, the "pull" of work incentives is as powerful a factor as the "push" of time limits and work requirements. This bolsters the case for expanding wage supplements, child care, health coverage, and other public supports for the working poor. Third, these supports more powerfully shape behavior than a higher minimum wage, which has played a negligible role in smoothing the path from welfare to work.

It makes more sense to index the minimum wage — let its value rise with inflation — than to view it as a principal tool for making work pay.

The exodus from welfare has begun to slow recently, probably because the most job-ready people already have left the rolls. Those who remain are apt to face many barriers to work: scant education and low skills (41 percent lack a high school diploma, as opposed to 29 percent of the leavers); learning disabilities; poor mental or physical health; domestic violence; and drug and alcohol abuse. There's little doubt that helping these mothers overcome multiple obstacles will be a more difficult and costly proposition.

Finally, we've made only modest progress toward another key goal of the 1996 law: reducing the number of out-of-wedlock births. After rising steadily, the number of out-of-wedlock births has leveled off but is still too high at 1.3 million a year. This is bad news, since children born outside of marriage, especially to teenage mothers, are much more likely to drop out of school, have children out of wedlock, and wind up on welfare.

Nonetheless, there are intriguing signs that a well-designed welfare-to-work system can begin to reweave the frayed bonds of marriage and family in poor communities. For example, a study of Minnesota's Family Investment Program by the Manpower Demonstration Research Corporation found that participants were 38 percent more likely than traditional welfare recipients to get or stay married. Such gains, however, don't come cheap: The Minnesota project provided generous supports to working mothers and allowed them to convert the value of their food stamp allotment into cash. "Parents with a greater sense of financial security may be more likely to marry," the study said.

All in all, a fair verdict on the progress of welfare reform after four years would be: Better than expected, but the toughest challenges still lie ahead.

—Will Marshall

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Beginning with a major 1993 expansion of federal support for the working poor and culminating in the landmark 1996 law ending the 61-year-old entitlement to cash welfare, the Clinton administration led the way in fundamentally revising the terms of the compact between society and the poor. By conditioning public assistance on work, it replaced the old ideology of "welfare rights" with a new social bargain based on mutual responsibility.

poverty fell sharply over the last decade, from 15 percent in 1993 to 11.8 percent last year. Child poverty likewise declined, from 21.8 percent in 1994 to 16.9 percent last year. The new president should commit the nation to bringing both the overall poverty rate and the child poverty rate below 10 percent in four years.

Driving poverty down is not simply a matter of spending more money, although that will indeed be necessary to raise the living

WORKING TOO MUCH: Too many Americans work two jobs just to make ends meet. This stocker in a Minneapolis supermarket works 70 hours per week.

Now that work has become a universal obligation, it's time for society to hold up its end of the bargain by making work pay. The problem is simple: Many of the bottom-rung jobs available to welfare mothers and low-skill workers don't pay enough to provide even a minimally decent standard of living for their families. The solution is to strengthen work incentives and rewards by supplementing the income of families with low-wage workers.

This formula is already working. According to social analysts Doug Besharov and Peter Germanis, total aid to the working poor increased by $25 billion a year between 1993 and 1999. Thanks to a strong economy and the big boost in public aid to working families, standards of low-income working families. We also need to modernize the rest of America's anti-poverty policies and programs. That means subjecting the whole array of federal needs-based social programs to hard scrutiny. No less than welfare itself, these programs — food stamps, Medicaid, child care, housing and transportation assistance, and others — need to be reinvented and reoriented around the twin goals of finishing the job of welfare reform and helping working families lift themselves out of poverty. This will not be easy: Each of these programs constitutes its own bureaucratic fiefdom with vocal, well-organized constituencies who can be counted upon to resist change. The administration must summon the political will

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Tax relief for working families

The Earned Income Tax Credit penalizes people as they rise up the ladder. Here's how to fix it.

by David R. Riemer

As America replaces welfare with work, we continue to be plagued by the law of unintended consequences. Here's an illustration:

A single mother and the father of her two children have been living together for five years — now they want to get married. She earns $12,000, he earns $20,000. Because of her low income, the mother will get an Earned Income Tax Credit (EITC) of $3,888, the legal maximum in 2000. They're confused about the tax laws but want to do the right thing for their children. So they seek advice from a minister and an accountant.

The couple: Should we get married?

The minister: Yes. You love each other. You want to get married. You owe it to your children, your faith, and God to stop living in sin and take wedding vows.

The accountant: But if you do, your earnings for EITC purposes will rise from $12,000 to $32,000, your credit will drop from $3,888 to zero, and you'll be taking thousands of dollars out of the mouths of the children you love.

The couple: Sounds like it would be immoral for us to get married.

The minister: Why does the U.S. government do this to me?

This, in one of its most brutal forms, is a prime example of the marriage penalty. In 2000, Congress passed a bill aimed at eliminating the marriage penalty for people with middle class incomes — but it was vetoed by President Clinton because of its cost. A fundamental flaw in the legislation was that it barely touched one of our tax code's biggest and most socially damaging taxes on matrimony: the penalty for low-income workers eligible for the EITC.

The EITC is a refundable tax credit that supplements the earnings of low-income workers. President Clinton in 1993 got Congress to approve a dramatic, $21 billion expansion of the credit as the cornerstone of his efforts to "make work pay." As a result, the once obscure tax credit has blossomed into the federal government's largest and most effective anti-poverty initiative. But the way it is structured imposes a heavy fine on marriage for millions of low-income workers with children.

The EITC marriage penalty, in fact, is part of a larger conundrum that has caught the attention of policy analysts and lawmakers: In our largely successful efforts to replace welfare with work, we've unwittingly created a new trap — a giant earnings tax. Here's how it works: As low-income families earn more money, the value of various public supports — the EITC, food stamps, and certain state tax breaks — begins to decline and eventually reaches zero. Meanwhile, low-income families are often required to make copayments, often a percentage of their income, to retain child care and health insurance. Economists see this phasing-out of public subsidies and phasing-in of copayments as tantamount to a tax on someone's private earnings and therefore a disincentive to further effort.

The earnings tax affects America's poor and "near poor" working families and even a large segment of the middle class. If a worker earns less than $6.25 per hour or $12,500 per year, work does indeed pay. Earnings get a 40 percent to 60 percent boost from a combination of the EITC, food stamps, and free or cheap child care and health care, which are also augmented by such state tax devices as supplemental state EITCs, Homestead Credits, and exemptions from taxation altogether. This pushes up a worker's disposable income to the equivalent of $8 to $9 per hour, or $16,000 to $18,000 per year. But once earnings rise above $6.25 per hour or $12,500 per year, work doesn't continue to pay for a huge segment of American families. Above $6.25 per hour, earnings increases translate for many into very sluggish growth in disposable income. At certain income notch points, where an extra $1 of earnings spells the loss of an entire benefit or the onset of a copayment, higher earnings actually yield lower overall income. The problem persists until about $15.75 per hour or $31,500 per year — a spread of $19,000 that encompasses a vast swath of the U.S. population.

The very programs that help workers under $6.25 per hour get above (or closer to reaching) the poverty line simultaneously punish workers making from $6.25 to $15.75 per hour, in the sense of causing their work to not continue to pay. The heart of the problem is the basic structure of the EITC, food stamps, child care and health care subsidies, and various state tax provisions that help the poor. All these programs have one thing in common. They impose a high tax on earnings, hitting hardest those making between $6.25 and $15.75 per hour.

For the EITC alone, the effective tax rate for a working mom with two kids is 21 cents for every dollar earned. Most of the

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other programs — food stamps, child care copays, health care copays, and state tax breaks — impose lower taxes on earnings, but they still pinch. Each program's separate tax on earnings might be tolerable if standing alone. But their combined tax rate is huge. Including the federal payroll tax that automatically takes 7.65 percent of every dollar, the cumulative tax rate often exceeds 50 percent, at times rises to near 70 percent. These high effective tax rates remain in place until as much as $15.75 per hour, at which point the EITC — and the huge portion of the combined earnings tax it imposes — disappears. If a wage earner has children, work doesn't pay much. Sometimes it doesn't pay at all.

When two people combine their incomes by getting married, the earnings tax becomes a marriage penalty. Because the EITC is based on total family earnings and drops rapidly when family earnings exceed the start of the EITC "phase-out range" ($12,690 in 2000), a worker with children often ends up worse off if she gets married to another worker. Especially if she's already living with him and they're sharing their incomes and household expenses, getting married frequently means a big EITC loss with few offsetting economic gains. Why marry?

Supporters of the EITC, food stamp advocates, and proponents of expanded child care and health care must begin to talk more openly and honestly about the unintended but very negative side effects built into the very structure of these programs. If we don't curb the powerful work and marriage disincentives that these programs create, then those who don't care about the poor will exploit program flaws to try to block further help for the working poor and the near poor.

Only a radical solution is possible. Just as welfare was so fundamentally flawed that it could not be reformed but required a complete replacement, the solution to the structural defects inherent in these programs is to eliminate entirely the current policy of phasing out benefits. Ultimately, we should also stop imposing copayments for child care and health care.

A WORKING PENALTY: When certain workers rise to $13,000 per year, like this court clerk in a typing class, they can start to lose their earned income tax credit and face a marriage penalty, too.

The logical starting point is the federal EITC. First, it is the biggest part of the problem. The EITC phase-out rate is the cause of the system's biggest work and marriage penalties. Second, today's bipartisan interest in cutting federal taxes offers a once-in-a-lifetime opportunity to fix the EITC's work and marriage penalties as an integral part of a popular middle class tax cut.

While minor adjustments in the EITC have merit, the only way to cure the huge work and marriage penalties built into the credit's phase-out is to abolish the EITC phase-out entirely. Just get rid of it. Let everyone who reaches the maximum credit — $2,353 for a family with one child and $3,888 for a family with two children — continue to qualify for the maximum credit whether they're poor, working class, middle class, or wealthy. Extending the maximum EITC credit to the middle class (and beyond) would thus become the heart of the middle class tax cut that Congress enacts.

From a Democratic perspective, this combination of EITC reform with a middle class tax cut is far more equitable than trimming the tax rate. The group that Democrats claim a special concern for, the poor and near poor, benefit twice: Their work is rewarded by rising incomes and their marriages aren't discouraged. But ordinary Americans — the Democrats' working and middle class political base — also win big. They get a big tax cut, and they get the exact same dollar tax cuts as the wealthy.

EITC reform also makes sense for Republicans who see it as a vehicle for cutting taxes. It cuts the taxes of the upper middle class. It cuts the taxes of the wealthy. It eliminates the penalty on both marriage and work, which they say they care about.

Obviously, ending the EITC's phase-out will be costly. But Congress seems poised to spend a lot of the surplus on tax cuts anyway. The question is not whether the federal government will cut Americans' taxes, but whether a large tax cut will perpetuate or end the current anti-work and anti-marriage bias of the tax code. Do we keep on punishing the poor and near poor or do we reward them for working and marrying as we lower taxes on the middle class and the wealthy?

If we end the EITC phaseout, everybody wins.

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Double the child tax credit

by Anne Kim

Make it refundable for low-earners

While Democrats opposed George W. Bush's campaign proposal for a massive tax cut, his package did include one idea worth salvaging: doubling the child tax credit. Created in 1997, the credit was designed to help families defray the cost of raising a child. With a little adjustment for low-income working families, this proposal could turn out to be an attractive option for reducing the EITC's work and marriage penalties described on the previous pages.

The adjustment would be to make the credit refundable, so that even families with little earned income would benefit. The child tax credit is currently worth $500 per child but only to families with incomes high enough that they owe income taxes. Bush proposed to raise the credit from $500 to $1,000, and to extend it to families with incomes up to $200,000 a year, up from the current limit of $110,000. His proposal would cost roughly $20 billion a year, but lower-income working families would still be left out.

Rather than extending the credit to more affluent families, Democrats should insist on making the credit available to families with low earnings (who typically pay little or no income tax but pay the full hit in payroll taxes). Combined with proposals for expanding the EITC (outlined in this issue by Will Marshall), this simple idea could provide common ground in the coming debate over tax cuts.

Doubling the tax credit and making it refundable would combine conservative and progressive goals. It would provide the general tax relief that Bush and the Republicans seek, while offsetting the tax penalties that poor families face when they go to work, get married, and begin moving up the income scale.

Another option is to make the credit partially refundable. According to the Brookings Institution's Isabel Sawhill, this would contain the credit's cost while also creating even stronger incentives for work. Under this approach, the credit would be tied to family income and would rise as earnings grow. But it could never exceed $1,000.

An expanded and refundable child credit, combined with a moderate EITC expansion, could prove to be a winning formula for the new president and Congress. It could be the tax cut that both progressives and conservatives could love.

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to overcome bureaucratic inertia and resistance from groups deeply invested in the status quo, including public sector unions and self-styled advocates for the poor who opposed welfare reform.

In 2002, the welfare block grant created in 1996 (called Temporary Assistance for Needy Families, or TANF) comes up for reauthorization, along with the main federal child care subsidy and the food stamp program. The president should block attempts to cut TANF funding and urge Congress to redefine its purpose to include providing supports to the working poor. Specific targets for moving children and families out of poverty should be written into the grant, with special rewards going to states that meet or exceed their goals. By launching a searching re-examination of federal social programs next year, the administration can begin laying the groundwork for merging TANF into a comprehensive income security and work support system for all low-income families.

Specifically, the president should take the following steps to begin creating a "seamless web" of aid both for families leaving welfare and for those who are working hard but are still poor:

1) Press the states to plow unused federal welfare dollars into the emerging support system for poor families. States should invest these idle dollars now, both in efforts to help hard-core recipients get on the job ladder and to make work pay for those stuck on the bottom rungs. As the welfare caseload has plummeted so has federal spending, which peaked at $23 billion in 1994. With the federal contribution now fixed at $17 billion a year, the states have been piling up unspent funds exceeding $8 billion.

Helping long-term and hard-to-employ welfare recipients will cost more, because it will engage a wider array of social services. In addition, states may need to create public jobs as stepping stones to full-time work in the private sector. The best model here is not "workfare," in which welfare recipients work off their grants, but "wage-paying community service jobs," which give workers a paycheck for the actual hours they work. A good model is Washington state's Community Jobs program, which gives mothers a chance to work 20 hours a week for a real paycheck, often in settings where they also get occupational training. Two-thirds of participants find full-time

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jobs after leaving the project. Also promising is the public-private Transitional Work project in Philadelphia, which places long-term welfare recipients in full-time community service jobs.

2) Break down bureaucratic barriers. Welfare rolls are shrinking, but thus far there are few signs the welfare bureaucracy is following suit. Moreover, state welfare agencies sometimes work at cross-purposes with state employment agencies which have actual experience in job placement. Separate federal funding streams contribute to the bureaucratic compartmentalization and the fragmentation of public resources that should be serving the same mission.

States need to trim their own payrolls, force separate bureaucracies to cooperate and retrain welfare workers whose jobs have changed from determining eligibility and handing out checks to helping prepare people for the world of work, match them to jobs and get other supports they need to keep working. Increasingly, their jobs entail more intensive case management to help parents overcome multiple barriers to work and to help working families get the support they need to exit poverty.

Getting multiple services now means running a bureaucratic gauntlet of programs, each with separate funding streams, eligibility rules, and reporting requirements. The administration should urge Congress to consolidate as many federal programs as possible into broad, performance-based grants that offer the states resources and flexibility in return for concrete results.

We also need to inject more choice and competition in welfare-to-work and other social services. Instead of trying to monopolize service delivery, government should do more to enlist the energies and talents of private actors, including businesses and nonprofit voluntary and faith-based institutions. For example, private companies such as America Works in New York and Maximus in Milwaukee have contracted with local authorities to prepare welfare recipients for work, find them jobs and, most important, keep them working. Through pay for performance contracts, government can stimulate a competitive market for welfare-to-work services while minimizing the risks of failure, since firms that don't produce don't get paid. Nonprofit civic and religious organizations such as Goodwill Industries play an important and growing role; the 1996 law included a "charitable choice" provision that allows states to contract with faith-based groups to help families leave welfare for work.

3) Expand the Earned Income Tax Credit (EITC). The welfare revolution began in 1993 when Congress approved President Clinton's call for a major expansion of the EITC, a refundable tax credit for low-wage workers. EITC spending more than doubled, from $18 billion to $30 billion, making it our largest and most effective anti-poverty program. The White House reported that the EITC lifted 4.3 million people out of poverty in 1998, more than twice as many as in 1993. The only blemish on the

"Instead of trying to monopolize service delivery, government should do more to enlist the energies and talents of private actors, including businesses and nonprofit voluntary and faith-based institutions."

ON THE ROAD: People leaving welfare often have difficulty getting to where the jobs are. We should find ways to help them purchase cars.

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"In addition to cracking down on 'deadbeat dads,' we need to help 'deadbroke dads' who can't pay child support because they don't have jobs."

credit's remarkable success is a high error rate (25 percent) which must be brought down if the program is to sustain political support.

The new president also should ask Congress to expand the minimum credit for families with three or more children and reduce the "marriage penalty" that occurs when two low-wage workers marry, pushing their combined incomes over a threshold that triggers reductions in EITC payments. As David Riemer argues elsewhere in this magazine, we need to revamp our tax system to reduce the steep marginal tax rates working families face as their incomes rise and EITC payments and other public subsidies begin to phase out.

4) Invest more in child care. For single mothers trying to move from welfare to work, the toughest challenge often is finding safe and affordable day care for their children. Although federal and state child care spending rose by 50 percent from 1993 to 1999 (from $8 billion to $12 billion), millions of working poor households still receive little or no help in paying for child care.

Following the lead of Wisconsin, Illinois, and Minnesota, the states should boost their own child care spending. For its part, Washington should increase the Child Care Development Block Grant and earmark the new money for child care vouchers. Vouchers expand choices for parents, who are best suited to judge whether informal arrangements or formal, center-based child care best suits their needs. It is also time to increase the child and dependent care tax credit and make it refundable, so that it helps families that don't earn enough to pay taxes.

5) Promote responsible fatherhood. Children who grow up without their fathers are five times more likely to be poor than children who live with both parents. While the first phase of welfare reform naturally enough focused on breaking the cycle of dependency for mothers, the next phase must demand more work and responsibility from fathers as well.

The Clinton-Gore Administration launched the most sweeping crackdown on "deadbeat dads" in history. It streamlined rules for establishing paternity and created a national directory to track delinquent parents across state lines. These initiatives, coupled with more vigorous state enforcement of court judgments, paid off handsomely: Child support collections rose to nearly $16 billion in 1999 — double the amount collected in 1992.

Nonetheless, some fathers are reluctant to pay up because the money goes straight to government, which then gives a portion of what it collects to the mother. The new administration should embrace Sen. Evan Bayh's (D-Ind.) fatherhood initiative, which would increase the "pass-through" to mothers as well as boost federal support for community-based groups that engage fathers in their children's lives. Also critical is public support for voluntary efforts to mentor the many poor children whose fathers are in prison.

In addition to cracking down on "deadbeat dads," we need to help "deadbroke dads" who can't pay child support because they don't have jobs. Taking advantage of healthy welfare surpluses, the states should build welfare-to-work systems that help fathers as well as mothers find jobs and hold on to them.

6) Help people go where the jobs are. Getting to a job is often more difficult for welfare recipients than finding one. Analysts Margy Waller and Mark Alan Hughes have noted that work requirements entail the time and financial costs of a daily commute, yet public transit too often fails to meet the needs of low-income workers. In a 1999 report, they wrote:

"Public transit is geared mainly to accommodate 9-to-5 workers who need to get from one high-density locale to another during the normal work week. In contrast, the entry-level jobs most welfare recipients are qualified for are often located in warehouses, plants, strip malls, and office parks that sit astride suburban roads rather than city streets. These new hires also often work 'on call' or on rotating shifts, or are assigned to work at night or on weekends when public transit is infrequent or simply not available."

What welfare mothers need to get to work and run daily errands is what everyone else has — a car. Public policy should make it easier for them to buy one. The administration should urge states to allow welfare funds to be used for purchasing a car, with a "copay" approach to ensure that aid goes to those who are working and are prepared to manage an asset like an automobile. It should also press for legislation that would allow poor families to use individual

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development accounts — tax-favored savings accounts where the government matches contributions made by low-income families — to save for a car as well as for other purposes such as college or home ownership.

7) Cover the uninsured. Studies show that most people who leave welfare for jobs do not get health coverage from their employers. Yet Medicaid use by the same group also has fallen. Just as it highlights flaws in our child care and transportation policies, welfare reform adds urgency to the case for universal health care coverage. Elsewhere in this issue, David Kendall and others propose a non-bureaucratic way to dramatically reduce the ranks of the uninsured.

8) Help working families buy homes. Housing policy can also be a powerful tool for matching welfare recipients to jobs. Rental vouchers can help low-income families move where the work is, while at the same time reducing the concentration of poor people in inner city neighborhoods and housing projects. The new administration should expand the U.S. Housing and Urban Development Department's welfare-to-work vouchers and its initiative to allow the use of Section 8 vouchers to help families buy their own homes. It can also promote home ownership by expanding individual development accounts, which help families save for down payments.

Conclusion

By realigning social policy with broadly shared values of work, family, and parental responsibility, "ending welfare as we know it" has gone a long way toward removing the stigma attached to public assistance. Americans are more willing today to spend more to help working poor families, as shown by polls as well as increased social spending in Washington and the states. To paraphrase a famous slogan from the republic's early days, the public's attitude seems to be: "Billions for work and self-sufficiency, not one penny for dependence."

The new administration should tap this revived spirit of public generosity and social responsibility to complete the welfare revolution and to set a new and ambitious goal for the nation: enable all working families to lift themselves from poverty. ▣

STAYING SINGLE: Quirks in the tax code penalize welfare leavers, like this single mother in Wisconsin, if they get married. This marriage penalty should be changed.

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Why it's time to revolutionize the military

by James R. Blaker and Steven J. Nider

The new administration's top defense priority should be the completion of the Pentagon's great unfinished business of the 1990s: transforming the U.S. military into a leaner, faster, higher-tech fighting machine. This transformation, known as the Revolution in Military Affairs (RMA), is imperative if we are to meet the dramatically changing threats of the 21st century. Begun nearly three decades ago, the RMA has hit a wall, and the new president needs to revive it. Unless we streamline, modernize, and restructure our forces, we risk becoming locked into a military structure that is unsuited to the demands that are now being placed on it. Today hostile powers can find increasingly affordable ways to counter American dominance, either through low-tech terrorism or high-tech cyberwarfare, thus weakening our massive advantage in conventional forces.

The defense debate during the last presidential campaign was modest and focused narrowly on readiness, the military budget, recruitment, and retention. The new president, and his secretary of defense, need to broaden and elevate the issue, making fundamental reform the centerpiece of defense policy. As commander in chief, the president can overcome service rivalries to force restructuring and mandate reform of a culture long wedded to parochial interests. Presidential leadership is the *sine qua non* of any serious military reform.

Today's military is still enmeshed in Cold War-era relationships, hierarchies, and planning based on the expectation of massive land warfare. Even with an overlay of smart weaponry and lightning-fast communications systems, our military is still built around a Napoleonic force structure — platoons, companies, regiments, brigades, divisions, and corps — more suited to a vast army of foot soldiers sweeping across Europe than a fully wired, fast-moving battle force that

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MOBILITY OVER MASS: This 19-ton, rubber-wheeled light armored vehicle is better suited to today's security challenges.

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If we don't speed up the shift to a modernized, fully wired military, hostile powers could use information technology to counter our dominance in conventional forces.

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can respond to such varied crises as Kosovo, Kuwait, and East Timor.

But money and technology alone are not the key to the RMA; the president needs to go beyond new weapons and information systems. Military transformation requires far greater integration of the four services, a revised force structure, and changed relationships, from the commander in chief to the Joint Chiefs of Staff to the thousands of military personnel — in effect, a shift in military culture.

As desirable as this sounds, there is in fact both institutional and political resistance to reform. Institutionally, officers up and down the military command structure have a vested interest, both careerist and budgetary, in the status quo. Rocking the procurement boat or shutting down a weapons design program, for example, has rarely advanced a military career. Politically, members of Congress focus on everything from spare parts to troop pay rather than the military's true difficulties: inefficiencies rooted in strategies suited for yesterday's war. Both the military and the politicians, by habit, seek to enhance what is already there rather than start over with something new. Pork barrel politics and concern with existing defense jobs play their usual role.

"China is already devoting major resources to developing a reserve force of computer experts and specialists in information warfare. It is trying to leapfrog its current outdated information systems to a sophisticated network of digital and satellite communications."

The result is not only a stubborn clinging to the wrong hardware and doctrine for coming confrontations, but a defense spending spiral that could soon be out of control. If we stick to our current force structure and procurement schedule, we will commit the nation to the mushrooming costs predicted by the military chiefs before Congress in October 2000 — $1.7 trillion over the next five years. This is about $200 billion more than the current budgets include; it is twice as much as Vice President Gore called for in the campaign and four times as much as Governor Bush advocated.

Countries that aspire to counter American military superiority — such as China, Iraq, and Iran — know they cannot succeed with forces built on Industrial Age terms: conventional force against conventional force. Recognizing that Information Age technology is a global commodity, they are studying how to apply it to their own military. Less constrained by entrenched structures and the culture of military superiority, they can find creative ways to exploit the seams in our current military structure and to develop new capabilities. Putting into practice what Americans mainly talk about, they may move quickly toward more comprehensive military intelligence, better communications, and precision use of force. Within a decade, some could achieve their own RMA, even before we complete ours.

China, for example, is already devoting major resources to developing a reserve force of computer experts and specialists in information warfare, according to a report by the Congressional Research Service. It is trying to leapfrog its current outdated information systems to a sophisticated network of digital and satellite communications which would allow it, for the first time, to project power and achieve information dominance over a competitor like the United States.

Hence the pressing necessity of consummating the American revolution in military affairs as quickly as possible and while we have a lead. We can update our hardware, alter the way the military is managed, and change the way we are organized to take advantage of America's comparative technological advantage. Because we can rely more on computer technology that drives the Information Age — technology that is marked by prodigious increases in capability and falling costs — we can build a better military at less cost than by staying on our current path. We could, if we decided to do so, complete the transformation of our military by 2010.

The Department of Defense (DOD) recognizes the benefit of transformation; the current plans of the military services and of the chairman of the Joint Chiefs of Staff all point to a more capable future U.S. military. Yet DOD's schedule for achieving the RMA is two decades. This is well beyond the time frame that requires decisions on resource allocations over the next five years. In short, to DOD — and military services in particular — the notion of true transformation remains a remote, conjectural possibility, not an urgent agenda item.

This resistance is rooted in fear of fundamental change in the basic structure and operational concepts of the military. Technology

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SIGHTING THE FUTURE: Tomorrow's land warriors will be equipped with integrated electronic sights, system voice control, and helmet electronics.

is transforming American society because the structures, organizations, and behavioral styles are also changing; the military must also be prepared to revamp its systems and fundamental concepts to take full advantage of America's technological edge. After all, we lead in the technology that drives the revolution in military affairs — advanced computer processing power, global networks, space-based navigation and observation, a wide range of integrated surveillance sensors, and a growing inventory of relatively inexpensive precision munitions. But to implement these technologies, we must restructure our forces to make them more agile, remove the organizational stovepipes that keep the services separate, and promote joint operations as much as the new technology allows.

To do this, we must fundamentally challenge the military cultures in which service competition is rooted. This is discomforting to many in the Pentagon. But we do not need a military force dedicated to the comfort and contentment of the defense establishment. We need a force that is better able to cope with the demands of rapid international change and proliferating military technology — a force that will be cost-effective today and in the years ahead.

In 1997, the Progressive Policy Institute outlined an RMA force structure that could be achieved by 2007 at roughly 15 percent less cost than Defense Department projections for its force structure plan ($2.2 trillion for the RMA force compared to a projection of about $2.6 trillion for the Defense Department plan). Since then, our estimates of the 10-year costs of moving to a true RMA force have increased somewhat, driven largely by expanding an interservice experimentation program to identify and reduce any unforeseen risks in making the changes we proposed. But the Defense Department's cost estimates for maintaining its current march into the future have also risen in large part because of the hurry-up recapitalization effort the department envisions to make up for low procurement funding between 1986 and 1997. The bottom line is that we now believe that putting in place a

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"The threats we face are far more ambiguous and differ both in degree and kind from what the Pentagon's current planning, programming, and budgeting system is designed to cope with."

RMA force by 2010 would cost as much as 20 percent less than what the military chiefs estimate for maintaining the current commitment to slow, incremental transformation over the same period.

To consummate the American Revolution in Military Affairs, the new president and his administration should:

1) Ensure that the new secretary of defense is committed to transforming the U.S. military within this decade. The new secretary must understand and believe in the promises of the American revolution in military affairs. He must be willing and able to assert control over the military services and to make significant changes in the way the Pentagon works. These changes should include:

• *Allocating more money for joint experimentation, while increasing the authority of the Joint Forces Command (JFC).* Created in October 1999 "to lead the transformation of the U.S. military," the JFC has been given neither the authority nor the resources to consummate the American RMA. It "leads" only where the Army, Navy, Air Force, and Marine Corps specifically say they have no interest, and it has been funded at one-tenth the level it requested for joint experimentation. The most important task is to establish a "Vanguard Force" under the JFC composed of about a fifth of the active force (e.g., two Army divisions, an Air Force wing, a Navy carrier battle group, and commensurate Marine Corps units). The Vanguard Force should be released from normal readiness requirements, equipped with cutting-edge technology, and assigned the task of developing new structures, organizations, and operational styles that take full military advantage of the new technology.

• *Reasserting civilian control over the military decisionmaking process.* This will require reducing the size of the Office of the Secretary of Defense (OSD) by up to 50 percent. Today OSD has twice as many people and four times as many separate offices filled by senior officials as it had at the height of its power during the Vietnam era. In the past when OSD had fewer subcomponents, the staff personnel often saw their role as strictly serving the secretary of defense. As OSD grew and became balkanized, that view was supplanted by one that emphasized representation of particular interests (health affairs, the reserves, the National Guard, etc.). The net result diminished the ability of the staff to speak with a single voice and the ability of the secretary to provide civilian balance to the power of the military. Returning to a smaller, less fragmented OSD will not just help restore a healthier balance between civil and military authority in the Pentagon, it will also help the Pentagon focus on its core mission of building the most effective U.S. military possible.

• *Breaking the monopoly of the military services in defining future military requirements.* Over three decades ago, Secretary of Defense Robert McNamara challenged what the U.S. military had considered its prerogative: to identify and define future U.S. military requirements. McNamara's assertion that he and his civilian staff should play an equal, if not dominant, role in defining future military requirements was highly controversial. Following his tenure as secretary, the authority for defining what was required to meet future threats shifted back toward the military, driven in part by a growing military staff dedicated to the effort. Today, it is the military that again has by far the largest say in identifying and proposing what the U.S. military requires in the years ahead. Yet the military is cautious by nature and focuses too much on maintaining its past Industrial Age capabilities. We need to introduce greater awareness of what the Information Age offers and will demand of the military of the future. We also need to reestablish a healthy balance between civilian and military authority in defining how the nation should design and build its military.

• *Refocusing the department's current Planning, Programming, Budgeting System (PPBS) to facilitate innovation and change.* The PPBS is the central process by which the Pentagon plans the size, structure, and character of future U.S. military forces. Created during the Cold War to deal with the Soviet Union, that process is now obsolete. It required agreement among all the participants on the specifics of a clearly defined threat, and because of the strategic need for stability in the U.S.-Soviet relationship, it favored incremental changes and improvements in U.S. forces.

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Today, the threats we face are far more ambiguous and differ both in degree and kind from what the Pentagon's current planning, programming, and budgeting system is designed to cope with. It inhibits the kind of experimentation and change needed for a 21st century force.

• *Cutting duplication of support functions among the four armed services.* These include logistics, communications, medical services, and intelligence currently provided within each military service and various defense agencies. A single military service should manage these four functions for all the military services. Such a consolidation would save billions by cutting down redundancy.

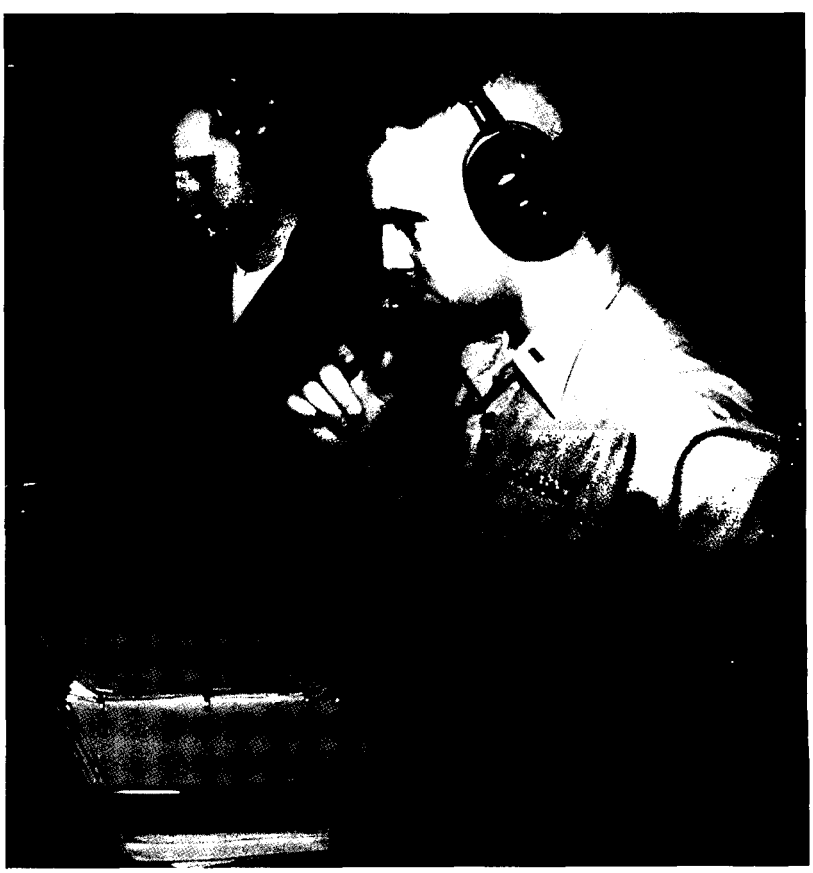
• *Modifying our overseas military command structure.* During peacetime, the military services assigned to a regional command do not often train and interact jointly. As a result, they are unable to work together as a joint force as quickly and efficiently as they should when force has to be used in real-life operations. For example, in Kosovo, Army Apache helicopters that had been deployed to the area could not be easily integrated into the Air Force's overall air campaign. The two services' inability to communicate and coordinate limited the effectiveness of the operation. We should not enter any military operation with a "pickup team" of military components that are inexperienced in operating together. One way to improve the current situation is to create standing joint commands at the three-star level — the operational level — so the different services interact in peacetime as they will during combat.

2) Supplement and support an activist secretary of defense by introducing legislation that will:

• *Close excess military bases.* There should be two additional rounds of a Base Realignment and Closure Commission. We have too large and dispersed a base infrastructure. Left over essentially from World War II and the Cold War, it is still capable of supporting three times the forces we have. Cutting the remaining base structure by about 25 percent would generate savings of about $3 billion annually within three years.

• *Establish a two-year cycle for defense authorizations and appropriations.* Currently defense budgets are on one-year cycles. This leads to frequent changes in planning at the expense of a longer- term perspective. By changing this, the planning process inside the Pentagon would become less frenetic and less expensive, allow military transformation to proceed faster and smoother, and save money.

The new president faces a special challenge at a unique historical moment. Currently celebrated as indomitable, the American military could in fact soon face technology-based encounters that it is ill-prepared to resist. Reviving the RMA needs to be an indispensable and early goal of the new administration. Just as President Harry Truman in his famous 1948 Key West meeting announced to the military chiefs that fundamental changes were necessary — and non-negotiable — President Bush should make this military transformation the cornerstone of his defense policy. ■



FORCE PROJECTION: Future military operations will rely more heavily on high-tech systems like this guided missile weapons center aboard the *USS Philippine Sea*, which played a key role in the 1999 NATO missions over Serbia.

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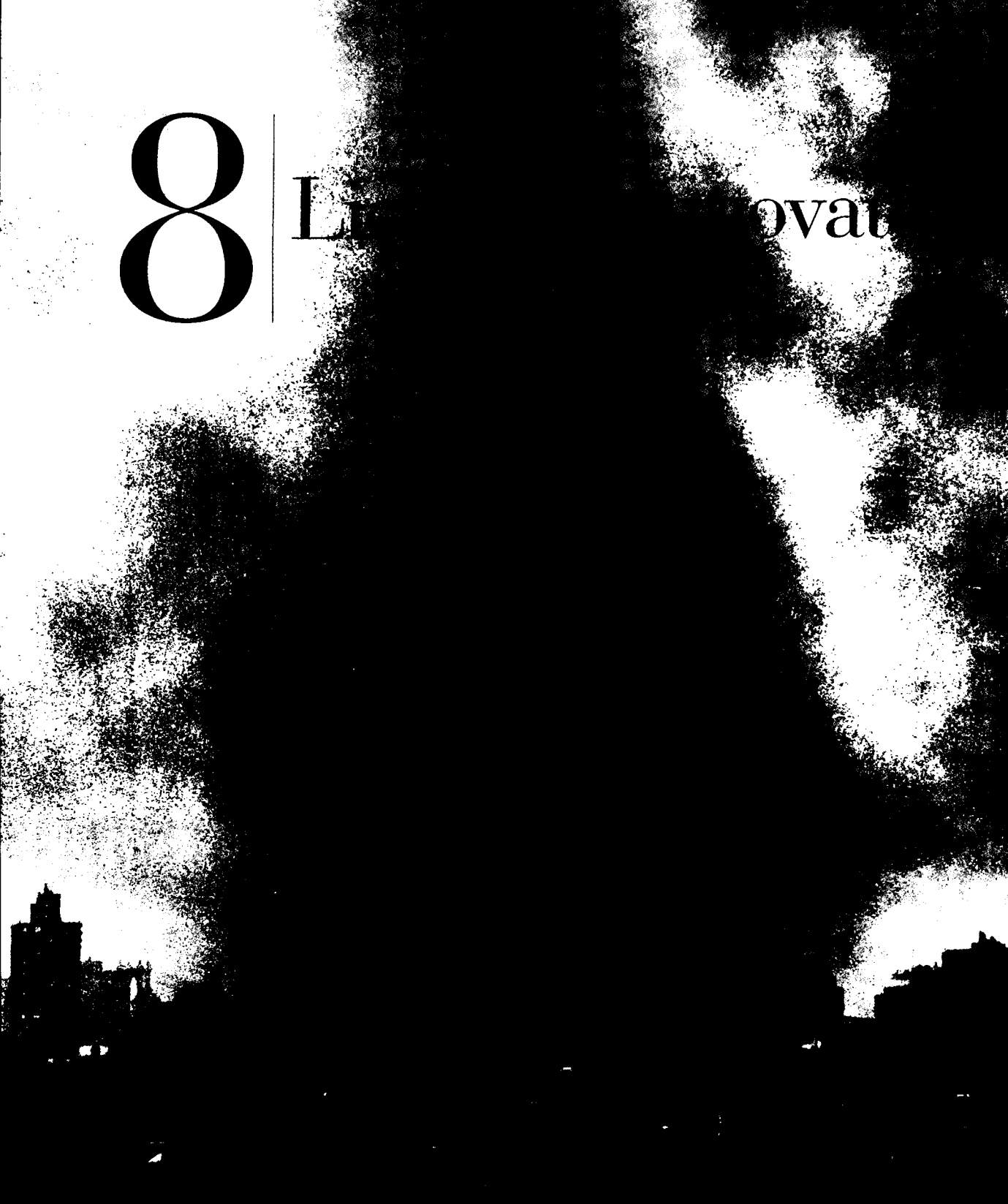

A TRULY BAD AIR DAY: Smog and greenhouse gases increasingly plague urban areas, like this portion of Manhattan in 1996.

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by Debra S. Knopman

America now faces more complex challenges than the cleanup of smokestack industries and municipal wastes that motivated the first generation of environmental laws 30 years ago. Global climate change, persistent smog, threatened and endangered species, and polluted runoff top today's domestic environmental agenda. First generation regulation continues to work adequately for some types of industrial pollution control, but it is too slow and inflexible to capture technological innovation in quick-moving markets. It is also too prescriptive to engage landowners and deal with small, diffuse sources of pollution and too narrow to mesh well with land use, energy, transportation, and agriculture policies.

This is why the new administration should champion second generation environmental legislation to give regulators, businesses, and communities license to innovate and experiment with tools better suited to solve today's environmental problems. Paired with this license to innovate should be a commitment to improve measures of air, water, land, and biological quality, as well as measures of government and private environmental performance. This can be achieved through the Second Generation of Environmental Improvement Act, soon to be re-introduced in Congress.

The Political Challenge of Altering the Status Quo

The political challenge for the new administration is to figure out how — not whether — to make further environmental progress on the heels of a decade of partisan acrimony and legislative gridlock. Conservatives need to acknowledge the public's desire for progress, while liberals must accept the fact that government needs new and more versatile tools to solve today's changed array of environmental problems.

Some argue for sticking with the first generation of environmental laws and their accompanying regulations. But they gloss over the fact that only marginal progress is possible under these prescriptive rules. Here's why:

• Current environmental laws and regulations do nothing to discourage rising emissions of greenhouse gases that already may be altering climate patterns throughout the world.

• Federally mandated efforts by states to reduce smog — and cope with tougher national standards — are falling short in many regions as Americans drive their vehicles more and old, coal-fired power plants remain online.

• Federal regulators have difficulty enforcing rules to protect the more than two-thirds of endangered and threatened species that live on private lands.

• Water quality problems from urban runoff, agricultural lands, hog and chicken farms, and suburban development cannot be as easily controlled as discharge pipes from municipal sewage treatment plants and industrial pollution.

The politics of each of these problem areas is complex, with broader economic interests in play than just big industry. States and local governments are key players in land use decisions that run through each of these controversies. No single, federally imposed strategy can carry the day.

Even for the challenges that the first generation laws were designed to address — cleaning up industrial pollution after it has been produced — acrimonious disputes about benefits and costs continue to slow progress. Indeed, much of our political energy on the environment is now dissipated in arguments about further reducing industrial pollution by government-prescribed means.

First generation laws have been rewritten and updated about as far as they can go; little gain is possible now by major rewrites. Progress can be made only in small increments until a broader public consensus is reached on new ways to tackle the big problems. Systematically testing new ideas and evaluating them with performance measures is a constructive way to break through the political gridlock. What makes second generation legislation different is that it would focus federal action on understanding problems, setting enforceable goals, providing technical assistance, measuring results, and enforcing legal commitments — while leaving the selection of means to others.

The Clinton administration made some notable progress in this direction, but lacking specific legislation, its many "reinvention" initiatives were necessarily modest in design and constrained by

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"Second generation legislation recognizes that the next wave of progress in reducing industrial pollution will likely come from sector-specific strategies that set clear environmental targets."

the administration's own rules and bureaucratic culture. Specifically, the Environmental Protection Agency's (EPA) Project XL (for excellence and leadership) demonstrated the pitfalls of trying new approaches without specific congressional approval of the right legal tools.

Among these are precisely what the second generation bill calls for — emissions trading, new approaches to polluted runoff in watersheds, and "whole facility" agreements instead of individual source permits. The legislation would also provide the legal basis for continued experimentation and innovation in environmental protection, consistent with a key recommendation of a November 2000 report by the National Academy of Public Administration.

Some members of Congress already have forged the path. In November 1999, Reps. Cal Dooley (D-Calif.), Ellen Tauscher (D-Calif.), Sherwood Boehlert (R-N.Y.), and James Greenwood (R-Pa.) introduced an early "work in progress" version of the Second Generation of Environmental Improvement Act (H.R. 3448). The bill measures success above all by environmental improvement, but also places a premium on improved accountability, public participation, and systemwide change. The new administration and Senate centrists should now join in drafting an updated version of the bill.

Innovative Strategies

Under the Second Generation of Environmental Improvement Act, regulators could pursue a broad array of experiments in environmental problem-solving without having to perform Houdini-like contortions on existing rules. They could try better and bolder experiments, evaluate their results, and take the next step of moving successful experiments into the mainstream of common practice. Here are just a few examples of the kinds of experiments that could be tried.

1) Pollution prevention and product stewardship. Pollution prevention, like disease prevention, often takes a back seat to treatment after pollution (or disease) has occurred. Recently, the EPA, Minnesota, and U.S. Filter Recovery Systems (a maker of industrial wastewater filters) reached agreement to waive an existing EPA rule that classifies used water filters as hazardous waste subject to specific disposal procedures. Instead, the water filter manufacturer will collect the used filters from its customers and recycle the materials, thus avoiding much higher volumes of waste disposal.

Existing rules do not necessarily block pollution prevention or product stewardship, but they rarely encourage it, and sometimes make it more difficult, as in the case of the filter recycling project. An important voluntary experiment completed in 1999 by Dow Chemical and the Natural Resources Defense Council also demonstrates this point. According to the participants, "the project found opportunities to reduce nearly 7 million pounds of wastes and emissions at the Dow Chemical manufacturing site in Midland, Michigan, while saving the company over $5 million dollars annually.... Perhaps more incredibly, by the reckoning of Dow managers, the reductions and cost savings ... would not have occurred without the unique involvement of a group of outside environmental activists." In other words, the current legal system did not expect Dow — now one of the nation's most environmentally advanced companies — to seek out these improvements.

Second generation legislation, by contrast, recognizes that the next wave of progress in reducing industrial pollution will likely come from sector-specific strategies that set clear environmental targets. Achieving these goals will rely more heavily on market-based incentives to reduce pollution, leaving technology choices to the private sector. Getting there must involve the entire industrial chain of manufacturers, suppliers, and customers. To work, it should reward pollution prevention, process innovation, and product redesign.

2) Performance incentives. A second generation law would let government and business systematically find out what incentives for better environmental performance actually work before enshrining them in difficult-to-change laws and rules. Some limited experiments are now under way. For example, New Jersey has been experimenting with a single permit for high-performing firms to replace the myriad individual permits for air, water, and waste discharges required under existing law. This "bubble" approach allows firms to comprehensively manage the sum of their emissions and discharges from their entire operation. When combined with a "lifetime"permit — in place of the standard five-year renewal process — this approach can allow firms to more efficiently manage their production processes while staying below overall emissions limits. If a firm increased production over time, it would be required to reduce emissions per unit of product to stay within its limits. The incentive is thus to invest in pollution prevention and new equipment, rather than to minimally comply with piecemeal regulatory prescriptions on individual pipes and smokestacks.

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Five essentials of second generation environmentalism

How to get citizens, businesses, and experts involved

The Second Generation of Environmental Improvement Act creates an atmosphere of innovation along with greater accountability for results. Some of its essential elements are below.

• *Target environmental priorities.* Too many of the past pilot programs initiated by the U.S. Environmental Protection Agency (EPA) and the states have lacked clear goals for environmental improvement like reducing exposures to high-risk chemicals or reducing the tonnage of smog-causing compounds. Second generation legislation would focus on climate change, smog, polluted runoff, and other top priorities.

• *Encourage risk-taking.* Under existing laws, the EPA and the states are constrained in their ability to try new ideas. For example, according to a new National Academy of Public Administration study, the EPA was reluctant to give Massachusetts the authority to cut the time dry cleaners have to hold on to environmental records in return for cleaning up their chemical emissions. Yet without the Massachusetts program, dry cleaners would remain outside the reach of regulators. The second generation bill would clear up the ambiguity over federal and state experiments that are either stretching the legal limits of existing law and regulation or, for lack of boldness, not stretching those limits enough. The legislation would also reward regulators and agencies that make significant efforts to advance innovative strategies.

• *Equip citizens, regulators, and investors with better environmental information.* For any strategy — new or old — to be credible, the public needs access to understandable measures of results and knowledge of who is accountable for those results. Not until the Toxics Release Inventory hit full stride in the mid-1990s was the full power of information disclosure recognized. The information technology revolution has opened the door to more direct and reliable methods of monitoring environmental performance. Second generation legislation would overhaul monitoring and public reporting by companies and government facilities and provide agencies and states with the funds to do the job. Further, if companies, states, and communities commit to producing timely, accurate, publicly available data from air, water, and other monitoring, they can earn the public's trust to meet standards by means of their own choosing.

LEADING INNOVATION: High-tech industries, like chip makers, need regulatory flexibility and license to innovate.

• *Support the growth of civic environmentalism.* Federal agencies with different legal mandates and bureaucratic traditions continue to have difficulty working together to help communities and regions solve their own particular environmental problems. Nowhere is this dysfunction more noticeable than in the continual clash between new federal spending on transportation, flood control, and other public works, and regional efforts to curtail the ill effects of suburban sprawl. Second generation legislation would strengthen the federal contribution to civic efforts to solve local or regional environmental problems through better coordinated agency actions, technical assistance, and enforcement actions.

• *Identify market-based incentives.* Whether through prescriptive regulation or market-based approaches like emissions trading, government implicitly sets the price of a clean and healthy environment. In today's rapidly changing New Economy, regulators should press for incentives that send a clear price signal to businesses and others to continuously improve their environmental performance. Second generation legislation would provide a legal platform to test and evaluate different incentive structures for different industries and places.

• *Invest in change.* Unfortunately, no one knows the real price of innovation and information improvements, although $300 million to $500 million over five years would be a reasonable starting point. Depending on the desired level of commitment and duration, Congress should give EPA and the states adequate funds to give innovation and information upgrades a chance to succeed — without undermining the foundation of existing environmental law and siphoning resources needed for permitting, compliance assistance, and enforcement. A safety net of credible enforcement of existing law must be maintained.

—Debra S. Knopman

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"Thirty years after the first Earth Day, most Americans share a common vision of a good environment. But if progress is to be made, Congress should equip the administration and the states with the tools to do the job."

Similarly, Wisconsin, Massachusetts, Minnesota, and the EPA are in various stages of testing special incentives programs for high performing companies that do more than the bare minimum to comply with the law. One of the biggest impediments to all of these experiments, however, is the lack of specific direction from Congress to offer positive incentives — like lifetime permits, more flexibility, less paperwork — instead of the now-standard fare of gold plaques and cheerful press releases. Second generation legislation could put some valuable economic incentives into play.

3) Smog, energy use, and transportation. Nowhere is the clash between environmental law, energy use, and transportation greater than in the challenge most states and regions now face to reduce smog. In an earlier issue of Blueprint, we advocated a market-oriented approach to reducing smog called emissions trading (BLUEPRINT, Vol.8, Fall 2000, "Sell Smog Now!"). First, regional and national limits would be set on smog-causing nitrogen oxides as well as greenhouse gases that contribute to global climate change. Then, major sources of these gases would be issued permits limiting their own emissions, but allowing them to trade permits among themselves. Every facility owner and vehicle fleet operator has the incentive to find the cheapest way to reduce emissions — through its own changes in equipment or operations or through purchasing cheaper credits from other sources.

Emissions trading thus would reduce pollution more efficiently than traditional regulation, spur new energy-efficient technologies, create incentives for vehicle fleet operators to purchase fuel-efficient vehicles, and make a down payment on the climate change threat. This is another example of a creative strategy that could be tested under the authority of second generation legislation. Such a program would have clear and measurable environmental targets; meld environmental, energy and transportation decisions; and encourage technological innovation. This is now a rare occurrence under our current laws.

4) Land use and water quality. No problem in water quality is more difficult than reducing polluted runoff from agricultural lands, suburban development, and other diffuse, hard-to-measure sources. These so-called non-point sources are responsible for more than 60 percent of the water quality problems in streams and rivers assessed by the states. As a consequence of a massive barrage of lawsuits by environmental organizations, the EPA is now activating an ignored section of the 1972 Clean Water Act called Total Maximum Daily Loads or TMDL. The TMDL program requires states to determine how much pollution a river, stream, lake, or estuary can assimilate; determine the sources of pollution and their relative contribution; and then assign reduction targets to each source.

What looks straightforward on paper is anything but that in practice. Putting a TMDL program in place is tenuous at best without good water quality monitoring data that describes how conditions vary over dry and wet periods, accurately identifies sources, and can detect and measure changes in source contributions over time. A General Accounting Office study issued in March 2000 concluded: "A vast majority of states reported that they have less than half the data they need to (1) identify non-point sources that are causing waters not to meet standards and (2) develop TMDLs for those waters." Politically, the TMDL program cuts right to the heart of many environmental conflicts: national mandates clashing with local land use prerogatives. Under second generation legislation, the U.S. Department of Agriculture, EPA, and the states could jointly structure a series of experiments to test ways to reduce polluted runoff, setting clear and enforceable environmental targets for pollution reduction, engaging the public early and often in program design, and tracking progress using advanced monitoring and remote sensing technologies.

Results Matter

Thirty years after the first Earth Day, most Americans share a common vision of a good environment. But if progress is to be made in the next 30 years, then Congress should equip the administration and the states with the tools to do the job. The Second Generation of Environmental Improvement Act is a constructive place to begin. Those who oppose new regulation as a matter of general principle may resist the suggestion that today's environmental problems should be addressed through federal law. Their preference for volunteerism, however laudable, is simply inadequate. Those who fought for the first generation of laws may resist the suggestion that our current body of laws is insufficient for the new challenges. They must acknowledge that regulatory modernization is a predicate for political consensus and further environmental progress. Both sides should welcome the opportunity that could be created by second generation legislation to innovate and experiment with more sustainable and efficient means to solve today's environmental problems. ▣

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Stalemate in The Hague

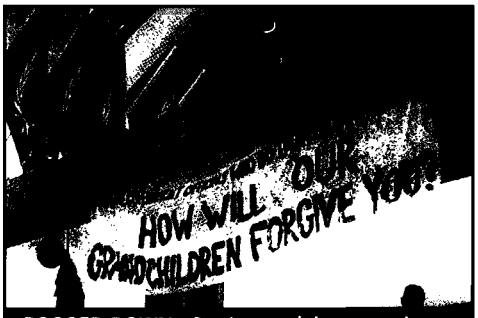
Putting policies into practice will advance the U.S. agenda

The biggest news in global environmental affairs was the failure last November of 175 nations to reach agreement on workable rules to reduce greenhouse gases. The meeting in The Hague was intended to fill in many missing details of the framework embodied in the 1997 Kyoto Protocol on climate change. The failure was regrettable and avoidable, but at this point, the key question is what should happen next. The obvious answer is that the United States should move even more decisively toward implementing real greenhouse gas reductions at home. By beginning to get our own house in order, we can show the world the effectiveness — and the real costs — of our market-based approach.

The biggest issue dividing countries, particularly the United States and European Union members, was the extent to which a country could take credit for "carbon sinks" in counting toward its required emissions reductions. Carbon sinks are the storage of carbon dioxide by forested and agricultural lands. This so-called "sequestration" option was a key reason the United States ultimately agreed to emissions reduction targets of 7 percent below 1990 levels in the Kyoto Protocol (still unratified by the U.S. Senate). Britain and the United States eventually worked out an 11th hour compromise, but failed to gain the acceptance of the European Union as a whole (led by France).

The environmental community was badly split on the compromise, with some of the moderate American-led groups arguing that some progress was better than none, and others stridently claiming that no deal was better than the deal at hand. Our view is that the United States is right to preserve as much flexibility in implementing Kyoto as possible while still maintaining the environmental integrity of the treaty.

The Progressive Policy Institute (PPI) has been asserting for the last two years that regardless of the pace of international negotiations, the United States should be laying the groundwork for its own domestic greenhouse gas emissions reduction program (see "Reframing the Climate Change Debate," by Jon Naimon and Debra Knopman, PPI, November 1999). It is becoming increasingly clear that American businesses would support a reasonable and efficient control strategy in return for long-term certainty.



BOGGED DOWN: Controversial proposals blocked agreement in The Hague, where protesters were out in force.

We have been strong advocates of emissions trading, which allows reductions of greenhouse gases to be made in the least costly way among all sources. Under a "cap and trade" approach, government sets an overall cap or upper limit on allowable emissions for the whole country, and then requires all sources to purchase or otherwise acquire credits corresponding to their actual emissions. In search of the cheapest way to meet its targets, an emitter of greenhouse gases could pursue any combination of five actions: make its own required reductions; buy reductions from other sources; bank its excess reductions for use in the following year or two; sell its excess reductions to others; or "retire" its excess reductions and thus take them out of the market (thereby accelerating emissions reductions).

The PPI plan continues to offer a prudent course for domestic action even as international agreement remains elusive in the near term. Our plan calls for a cap on emissions at year 2000 levels and then a gradual 1 percent per year decline in the cap for at least the next 10 years. A broad-based domestic emissions trading program would minimize overall economic costs, provide critical experience in developing the institutional and regulatory arrangements necessary to operate a credible trading scheme, and demonstrate the value of emissions trading to the rest of the world. Most important, the PPI plan would establish an unambiguous price signal to drive energy efficient investments, new energy technologies, and changes in consumer behavior. This outcome is clearly in the national interest.

On the international scene, in the finest tradition of United Nations-sponsored enterprises, The Hague participants were able to agree on their next meeting date: May 2001 in Bonn. But this hardly leaves time for a new U.S. administration to assemble its negotiating team, let alone work out a new negotiating position, consult with Congress, and educate the public on the path ahead. From a U.S. perspective, the May meeting is premature and could be counterproductive. If the meeting takes place, the United States would be well-advised to have a politically feasible domestic emissions reduction plan in its pocket as a sign of good faith and intent to make real and lasting reductions. The PPI plan would fit the bill.

—Debra S. Knopman

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Crime story: the digital age

Harnessing new technologies to community policing.

by John D. Cohen, Adam Gelb, and Robert Wasserman

The crime news these days is mostly good. Over the last eight years, crime rates have plummeted to the lowest levels in decades. Sustained economic growth, reduction in the use of crack cocaine, tougher gun laws and enforcement, and more cops on the beat have combined to make America's streets safer than at any time since the first reliable statistics were collected in the 1960s. Many of these improvements can be attributed to a surge of community policing techniques around the country that have fundamentally altered the philosophy of how many police departments work and the way they interact with their communities.

Yet for all the good news there are troubling signs on the horizon. Crime numbers are not continuing to plummet everywhere (for example, in Dallas and Houston, Texas, and Tampa, Fla.). New drugs such as ecstasy may reinvigorate the narcotics trade. Racial profiling and a perception of unequal law enforcement has cast a pall over improved relations in areas where community policing was beginning to make a difference. And, perhaps most worrisome, demographers forecast by 2010 a bubble of 4.4 million more youths in the crime-prone 15-to-24-year age group.

What does this mean for the new administration in Washington? It means that an aggressive new crime-fighting strategy — and appropriate funding — must emerge from Congress to help cities and states get a handle on coming crime problems before they spin back into pre-1990s numbers. This anti-crime agenda should build on the new view of community-based crime fighting developed in the last decade and focus on three key priorities:

1) harnessing the new information and communications technologies to give law enforcement agencies new crime-fighting tools;

2) expanding community policing programs with strategies aimed at dangerous people in dangerous places;

3) replacing racial profiling with criminal targeting.

How We Got Here

To understand the choices we face today in crime fighting, it's important to understand how we got where we are. In the early 1990s the nation was mired in an ideological impasse on crime fighting, in which liberals demanded more money to attack social inequities and conservatives insisted on harsher punishment for criminals. President Clinton proposed a Third Way: a new focus on preventing crime by expanding the number of police and deploying them in more creative ways.

The cornerstone of the Clinton administration's anti-crime

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BEATING BAD GUYS: Digital equipment and updated software helps pinpoint hot spots and repeat offenders better than old-fashioned hunches and random police cruising.

policy was the establishment of the Office of Community Oriented Policing Services (COPS) within the Department of Justice. COPS provided funding for 100,000 new police officers both to help undermanned police departments around the country and to encourage them to adopt the new, community-oriented policing strategies that had shown great promise in San Diego and other communities. Since its inception, the COPS office has provided more than $6 billion in grants to state and local agencies for technology and new police officers. The COPS office reports that because of its efforts, 109,139 new police officers are working with community members to make neighborhoods safer.

While the "100,000 cops" initiative grabbed most of the headlines, the most important accomplishment of the COPS program has been strategic: It has shifted the basic policing approach away from the old "911" model known as calls-for-service. This reactive approach is now moving toward community collaboration and preemptive problem solving. Instead of driving around randomly in cars and responding to emergency calls, police are now on foot and on bicycles so that they become visible fixtures in neighborhoods. They work with community leaders to identify conditions that breed disorder; they share information about potential problems; and they forge common strategies for preventing crime, not simply catching criminals after the fact.

In short, community-oriented policing has reconnected police with the communities they serve. It has also breached the bureaucratic barriers that prevented multi-agency responses to the quality-of-life problems that facilitate crime, such as broken streetlights and abandoned buildings. Effective crime prevention requires that lights be repaired so that crimes aren't cloaked in darkness and that abandoned houses be condemned and razed so that they cannot be used for prostitution and drug trafficking. Thus, "broken windows" environments are eliminated before they begin attracting or reinforcing criminal activity. Even filling potholes is good policing policy — it frees officers from directing traffic to catching criminals.

Community-oriented policing also helps break down the stovepipe mentality of public agencies. It allows government and citizens to work together to tailor solutions that fit the crime problems in individual neighborhoods. It is supported by emerging information technologies such as wireless data and the Internet to improve the delivery of government services.

Agenda for the Future

Building on these successes, the new administration should pursue a technology-driven agenda for the future that breaks into three key parts – increasing COPS funding for technology tools, targeting hot spots and repeat offenders, and replacing racial profiling with criminal targeting.

1) Boost the technology budget of the COPS program. The federal government should push crime fighting into

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the digital age by providing national standards that support the deployment of cutting-edge information and communication systems. Through the COPS office, it should funnel seed money to state and local governments.

Rapidly collecting and disseminating good information about the people who commit crime and the places where crime occurs is the key. Yet most police, parole officers, and courts are operating with 20-year-old information technology. Even though high-speed digital technology is already available, many cops must still wait 20 minutes for basic information about a vehicle or person they've stopped (digital technology can obtain and transmit a car's record in 10 seconds). Days or weeks can pass before criminal warrants find their way into computers, leaving dangerous criminals on the street and police unaware they are wanted. Judges sentence offenders without seeing their criminal history records.

"Most police, parole officers, and courts are operating with 20-year-old information technology. Even though high-speed digital technology is already available, many cops must still wait 20 minutes for basic information about a vehicle or person they've stopped."

Some states, such as Pennsylvania, Maryland, and North Carolina, are working to establish statewide networks that improve information sharing and voice communication between the various components of the criminal justice community. These networks will link state and local law enforcement efforts and non-law enforcement agencies.

In addition to these initiatives, the criminal justice community must adjust to the new phenomenon of cybercrime. As criminals use communications and information technologies to commit traditional crimes in new ways (forgery, identification theft, drug trafficking, child pornography) and to devise entirely new types of crime such as cyberterrorism, law enforcement agencies need to make a techno-leap in crime fighting. This will require substantial new funds and training in areas about which police today have little knowledge.

2) Hit the bad guys where they work. Research on crime convincingly demonstrates two central facts: that crime is highly concentrated in geographic areas, with as much as 50 percent of offenses occurring at just 3 percent of locations; and that a small subset of criminals is responsible for a vastly disproportionate share of crime, with an estimated 5 percent to 7 percent of offenders committing from 50 percent to 70 percent of total offenses. To take advantage of this research, the Justice Department should establish a grant program to support local efforts to target crime hot spots and high-risk offenders.

Other research tells us that certain programs work. True community policing can shut down a drug market and keep it shut down while a traditional street-corner sweep would simply move dealers down the block. A strict regimen of drug testing and treatment, backed up by escalating penalties for violations, can dramatically cut drug use among offenders. Structured after-school activities linked to students' schoolwork can reduce juvenile crime and gangs, as well as drug use and teen pregnancy.

When well managed, each of these efforts can produce results. But used alone, no single approach can hope to turn a blighted neighborhood around, so they must be combined. Crime mapping technology can identify these crime-ridden areas and be used to track, in real time, shifting and emerging patterns so police can get a jump on new trends. Local leaders must coordinate a comprehensive effort with all government resources — policing, parole, prosecution, prevention, drug treatment, nuisance abatement, housing, and business development.

3) Eliminate racial profiling and develop criminal targeting. Racial profiling is the single greatest threat to the progress we've made in crime reduction. To counter the practice, a number of states have passed legislation that requires police departments to track traffic stops with an eye to patterns of profiling. Some police departments are under scrutiny by the U.S. Justice Department because of allegations of racial profiling and brutality. Yet tensions between police and minority communities continue to increase — to the point that some police chiefs fear they are just one nasty incident away from an outbreak of civil disobedience. Law enforcement action, whether stopping a motorist, prosecuting a case, or sentencing an offender, must be based on more than statistical probabilities. Police executives must support anti-profiling policies by collecting verifiable data on the contacts that their officers have with citizens and by taking

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appropriate action against those who exhibit prejudice.

Law enforcement officials must also become more much sophisticated about the nature of our cultural prejudice. They should develop a deep and meaningful appreciation of how practices based on invalid assumptions can be perceived as discriminatory by people of color. Then they can become effective and impartial enforcers of the law. They must also understand that racial profiling is ineffective as a crime prevention tool because when police devote time targeting innocent people, criminals are free to commit crimes. Finally, they must understand that racial profiling breeds distrust in the very communities that need aggressive policing, reinforcing racial stereotypes.

Among the tools necessary for color-blind law enforcement are technologies to collect data on traffic and subject stops. But data collection is not enough. The widespread belief that police routinely engage in racial profiling has more to do with outmoded reactive and random crime control techniques traditionally used by police than with overt bias. Ironically, the very Justice Department that is now at the forefront of ending racial profiling promoted the use of profiling as a tool to interdict drug shipments.

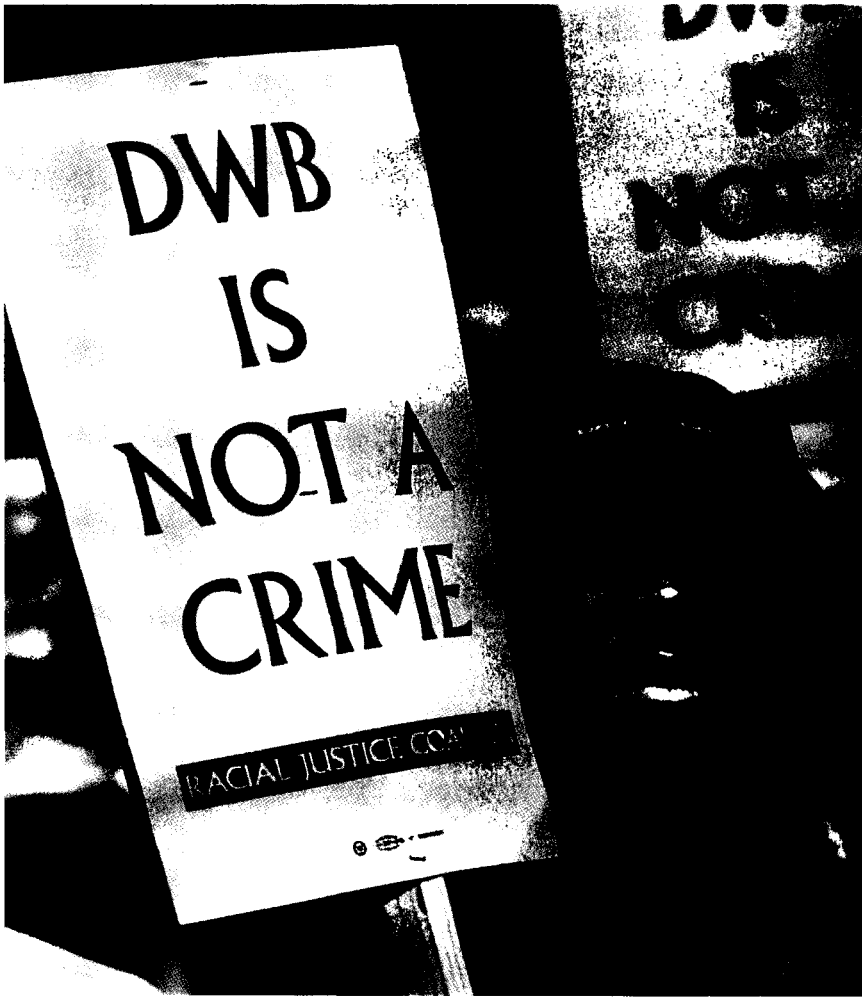
The federal government should take a leadership role in eliminating racial profiling and replacing it with criminal targeting based on faster access to good information. Washington must make it a priority to provide police officers the needed technology so that they no longer rely on hunches; then they can target the people who are actually involved in criminal activity. With real time access to information that targets people who have committed crimes as opposed to members of racial and ethnic minorities, police can do a more effective job.

Conclusion

Sixty years ago, advances in technology — the patrol car and the two-way radio — offered great promise to improve the effectiveness of law enforcement. Unwittingly, these advances separated police from the citizens they are sworn to serve.

The recent movement toward community policing has started to rebuild those bonds. Now, the technology boom must be aggressively used to exchange information and establish stronger ties between all government agencies and citizens.

Police action alone can never free neighborhoods from crime and violence. Nor by itself can it reduce fear. Only when law enforcement is viewed as an integral part of a fully accountable government structure will we be able to systematically create strong communities resistant to disorder, decline, and crime. ■



DRIVING WHILE BLACK: Racial profiling drives a wedge between aggrieved citizens and the police. Besides being unjust, it is also poor police work. Digitally-based criminal targeting is far more effective.

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The carrot & the stick

Why mandatory drug treatment for prisoners and parolees can be a major crime-fighting strategy

by Eric B. Schnurer and Charles R. Lyons

As a centerpiece of its crime-fighting policies, the new administration should encourage the states to adopt a new approach to reducing recidivism by coercing America's criminal population — those in prison and those out on parole — to participate in mandatory drug treatment programs. This carrot-and-stick approach, combining both punitive and therapeutic elements, bridges the historic divide between conservatives and liberals over how to treat criminals. It could become a major crime-fighting tool just as social scientists are predicting a coming demographic bubble of young men in the crime-prone years.

While research clearly shows that drug use is one of the highest correlates to crime and recidivism, conservatives and liberals have fought for years over the proper approach to drug addiction and crime. The conservative impulse to retribution and the liberal inclination toward rehabilitation have created a false choice that has hamstrung the political will, preventing implementation of programs most experts think will work. The liberal approach does not satisfy the public's demand for tough-minded punishment; the conservative approach fails to address the root of the problem; and, in fact, neither alone is effective. A Third Way is required, combining the coercion of punishment and the helping hand of treatment: in the context of drug crime, mandatory detoxification and ongoing drug rehabilitation, in prison and out.

Making the therapeutic approach "mean and mandatory" and incorporating it into a convict's sentence makes it punitive, and thus politically palatable. It also makes it more effective, according to studies. The politics thus match the proper policy prescription.

In fact, a number of states — Delaware, Oregon, and Massachusetts, for example — have already instituted treatment programs that require convicts to test drug-free for a period of time (between 30 days and six months) before release or serve more time. For the three-quarters of those in the criminal justice system who are out of prison, "coerced abstinence" programs require testing thrice weekly and impose immediate but graduated sanctions (overnight incarceration for the first positive test or missed treatment session, two days for the next, etc). In short, these programs focus on the realities of defeating addictive behavior, combining therapy and punishment in an effective and mutually reinforcing system that is highly cost-effective. Known as "Drug-Free to Go Free" and "Drug-Free to Stay Free," these programs are "coerced" (punitive) in the sense that offenders are given an unappealing choice — extended incarceration — as the alternative to not "buying in" to the treatment regime.

The correlation between drugs and crime is overwhelming, and it expresses itself in rampant recidivism, the drive shaft of crime. More than 80 percent of state convicts, and 60 percent of federal convicts, are recidivists. Drugs are a major factor in the cycle of crime: Criminal offenders use drugs, commit crimes to buy drugs, and are under the influence of drugs and alcohol when committing non-drug crimes. Recently retired Drug Czar Barry McCaffrey said in 2000 that 50 percent to 85 percent of the nation's inmates were in jail or prison primarily because of drug or alcohol abuse. Nearly 60 percent of federal prisoners in 1997 were sentenced for drug offenses, almost all for trafficking — and the number is rising. About one-fifth of all offenders commit their crimes specifically to obtain money to buy drugs. In major cities, 60 percent to 80 percent of arrestees test positive for at least one drug; about half of those charged with crimes involving violence or money test positive for more than one drug.

It should therefore be little surprise — although this fact is resisted by self-styled tough-on-crime advocates — that drug treatment is one of the most effective tools in reducing crime, especially repeat crime. In 1992, the California Drug and Alcohol Treatment Assessment, or CALDATA, found a two-thirds decline in the level of criminal activity by participants in its drug treatment programs. Treatment costs totaled $209 million — but the savings to taxpayers were estimated at $1.5 billion, mostly in reduced crime. In 1998, a federal Bureau of Prisons study found that in the first six months after release, prisoners who had participated in drug treatment programs were 44 percent less likely to have used drugs again and 73 percent less likely to be re-arrested.

What is crucial is the newer recognition that coercion seems to make treatment more effective. Research shows that the threat of more incarceration is a huge

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motivating factor in keeping prisoners in treatment. When "graduates" of the Brooklyn, N.Y., district attorney's Drug Treatment Alternative-to-Prison (DTAP) program were asked why they stayed in treatment, "almost all of them agreed that prison avoidance was a very important, if not the most important, reason for resisting the temptation of dropping out," according to a report. And forced drug treatment programs also have shown higher success rates than voluntary ones. A large body of literature demonstrates that offenders coerced into treatment have better long-term recovery rates than those who enter by choice.

Despite the original perception that coerced "treatment" could not possibly be as effective as voluntary treatment, there are good reasons why coercion works. The single most reliable predictor of post-treatment outcomes is length of time in treatment — the longer the person is in treatment, the more likely it is that he or she will respond positively. And, very simply, coerced programs generally compel longer treatment — as well as jump-starting treatment to begin with.

Our political quandary — finding the proper balance between the carrot and the stick — is rooted in American ambivalence toward criminal justice. The conservative-liberal dichotomy is reflected in such dualistic terminology as "penal system" and "corrections system," or "prison" and "penitentiary" — the latter term coming from an 18th-century conception of convicted criminals sitting quietly in their cells and growing "penitent" through introspection. In recent decades, this dichotomy has manifested itself in opposing philosophies that view crime as either willful behavior deserving punishment or as a "disease" provoked by factors such as poverty, racism, or troubled family life, thus rendering the offender a victim in need of treatment.

Ideological differences aside, experts increasingly recognize that both therapeutic and coercive elements are essential to reforming behavior, in both criminal and non-criminal settings. Explaining the success of his program, the president of a nonprofit juvenile correction program in Nevada said, "Demands of the program create a stress which makes the boy receptive to counseling. Counseling, in turn, helps the boy succeed with the program requirements and internalize the values which are taught." Similarly, welfare policy has long suffered from the same ideologically imposed schizophrenia as crime policy, with some believing that welfare recipients need a stick to get motivated to get off welfare; others, that they need more assistance to do so. But existing studies in a number of states suggest that, given the habitual nature of the underlying problem, sanctions are by themselves not sufficient to break bad habits; very simply, many people need help, too — which is why a number of states employ various approaches in aiding welfare recipients, either before, during, or after the imposition of sanctions. And it is why progressive reformers have pushed for real welfare reform encompassing both greater individual responsibility (with sanctions) and expanded supportive services.

In short, the stick without the carrot — or vice versa — is like one hand clapping. It is clear that people behaving antisocially need both help and coercion. A punitive threat backs up the offer of help through drug treatment; but the treatment is essential if the punitive setting is to be used to modify behavior after punishment has been received. This synergy is an effective approach that can, if promoted by the presidential bully pulpit and adopted by the states, have a profound effect on America's continuing and coming crime wave.

DRUG-FREE TO GO FREE: Inmates like this woman in a California prison can join drug treatment programs to get out and stay clean.

Making the therapeutic approach "mean and mandatory" and incorporating it into a convict's sentence makes it punitive, and thus politically palatable.

Eric B. Schnurer is president of Public Works, a policy consulting firm. He is also a member of the Pennsylvania Commission on Crime & Delinquency. Charles R. Lyons is vice president of Public Works.

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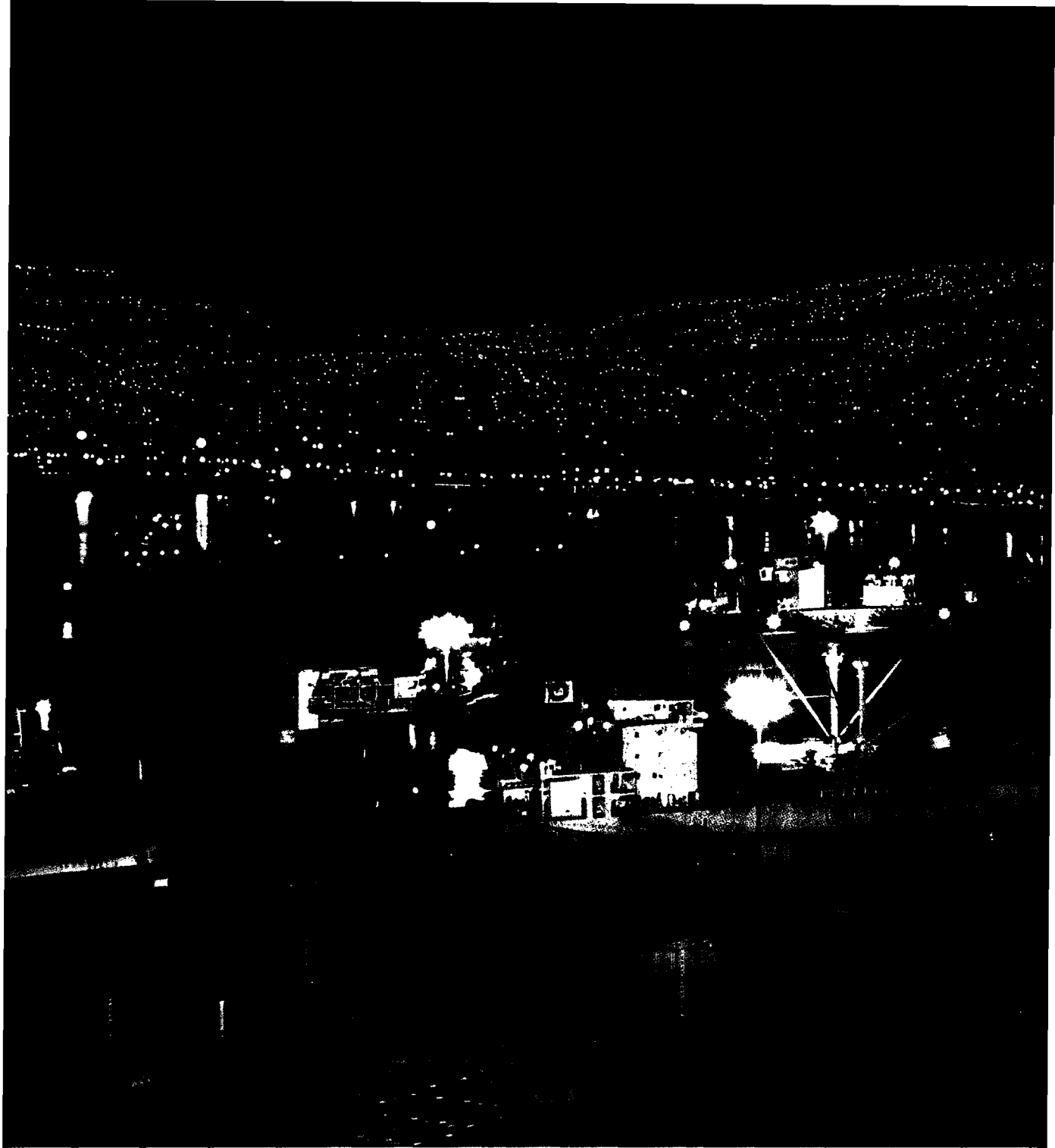

Without aggressive leadership, the United States may lose out in the competition for Latin American markets.

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BOOMING MARKETS: Rising exports, like these passing through the harbor in Valparaiso, Chile, make Latin America an attractive market. Who will benefit most: Europeans or Americans?

10 The Free Trade Area of the Americas:

Why the United States must take the lead

by Jenny Bates

Exactly three months after moving into the White House, the new president will face one of the biggest foreign policy challenges — and opportunities — of his term. In April 2001, at the Summit of the Americas in Quebec, he can assert U.S. leadership in the creation of a Free Trade Area of the Americas (FTAA) — a $10 trillion common market of 800 million people stretching from the Bering Strait to Tierra del Fuego. By taking the lead at a critical moment in the FTAA's formation, the president can ensure that it reflects U.S. interests and values while locking in Latin America's movement toward democracy and economic reforms. Failure to lead the way into this enormous and unprecedented free market, furthermore, would be costly: The United States could be shut out of Latin American markets, regional protectionism would rise, and the leadership vacuum would be filled by another powerful player such as Brazil.

Jenny Bates is international economist at the Progressive Policy Institute.

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"Forging strong ties through trade and investment increases the possibility for cooperation on a host of other issues of common concern, such as illegal drug trafficking and environmental degradation."

Preparations for the FTAA — which will reduce barriers to trade, spurring competition and economic growth throughout the hemisphere — have been under way since 1994, and formal negotiations were launched in 1998. And while the U.S. government has publicly supported the process, the administration's attention has mostly been elsewhere as working groups did the initial yeomanship of trade talks. Now, however, the momentum to create this vast new trade area is entering its crucial final phase. Over the next two or three years, the most important decisions will be made. If the result is to be favorable to the United States, both economically and politically, White House leadership is urgently called for. As the largest player in the region, the United States cannot afford to sit on the sidelines.

There are other reasons why the FTAA should be a top priority for the new president. Locking in the economic reforms among Latin American economies of the past two decades, for example, will spur continued growth and reinforce pressure for political reform. Such a commitment will reduce risk for investors, spur inflows of much-needed foreign capital, and promote development. Such economic liberalization can also challenge powerful, entrenched interests and liberate opposition forces to push for democratic change. Indeed, in most countries in the region, economic reform has gone hand-in-hand with progress on the political front. According to a Freedom House study, the major economies of Latin America have moved from "unfree" to "free" since the 1970s (though there has been some danger of backsliding in the Andean region recently).

The best case in point is Mexico. The election of a new Mexican president, Vicente Fox, in July 2000, represented a genuine democratic transition of power, ending more than 70 years of authoritarian rule, and is arguably proof that the North American Free Trade Agreement "worked." Fox himself recognizes the connection between opening an economy to external competition and subsequent political and democratic reform. In a speech in Washington soon after his election, he noted that "the Mexican transition will be developed respecting the political identity of every Mexican, with a constructive spirit, with a firm promotion of plurality, with a solid ethical commitment, with respect for the rule of law, and mainly with doors open to the world." Not surprisingly, Fox is also a strong supporter of the FTAA.

Making admission to the proposed FTAA conditional upon a functioning democracy (free elections and a democratic form of government) could provide a powerful incentive for countries to move ahead with democratic reform, much as potential membership in the European Union (EU) has spurred reform in the candidate countries of Eastern Europe.

The FTAA could thus form a basis for a broader "community of democracies" in the Western Hemisphere. The negotiating process to date has already improved communication between government officials and helped build trust between the nations of the region. Forging strong ties through trade and investment increases the possibility for cooperation on a host of other issues of common concern, such as illegal drug trafficking and environmental degradation. Addressing such emerging global challenges will require much more of this sort of consensus building and common action by policymakers, particularly between developed and developing countries.

The deadline for completion of the FTAA is Dec. 31, 2004. But much needs to be done before then. Countries must make specific commitments to significantly lower tariffs and eliminate other barriers to trade. They must agree on rules to govern investment, government procurement, and dispute settlement. They also need to find new and innovative ways to address legitimate concerns arising from globalization — such as workers' rights and environmental degradation — without restricting the trade and investment that the poorer countries in the region so desperately need.

The Economic Stakes in the FTAA

In addition to the need to consolidate economic and political reform in Latin America, however, there is the simple question of economic advantage. Does the U.S. economy stand to benefit from the deal? The answer is clearly yes.

First, it will open new markets in Latin America and the Caribbean to U.S. farmers, companies, and small businesses. Today, American trade with the proposed FTAA countries

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GENERATIONAL CHANGE: Latin America's newly democratized countries and freer markets are creating a new prosperity for people like this family in Buenos Aires. The United States can benefit from a free market of 800 million people.

excluding Canada and Mexico is a paltry 8 percent of our nation's trade. U.S. firms currently face significant entry barriers in Latin American markets. Tariffs average 10 percent to 15 percent, compared with zero on virtually all trade with Canada and Mexico. Some sectors face much higher barriers — American automobiles face a tariff of 35 percent in the countries of the Mercosur common market, Argentina, Brazil, Uruguay, and Paraguay. Clearly, the removal of barriers to trade with Latin America presents one of the greatest opportunities to expand markets for American producers.

Second, the FTAA will act as a buffer in times of economic crisis and rising protectionism. During the 1980s, Mexico responded to its currency crisis by raising tariffs and shutting out U.S. exports. In contrast, commitments under the NAFTA, implemented in 1994, kept the Mexican market open following the peso crisis, allowing U.S. exports to continue and even increase. The FTAA would guarantee U.S. access in a similar way by legally binding members' commitments to lower tariff and nontariff barriers.

Third, the proposed FTAA will have a unifying effect on Latin America by reducing complexity and uncertainty in economic relations. There are currently more than 20 subregional and bilateral free trade pacts in Latin America and the Caribbean, with many more under discussion. This highly complex web of overlapping preferences reduces transparency for business and distorts incentives for trade and investment. By pulling together all of the players under one agreement and committing them to the principle of "most-favored nation" (the benefits given to one country must be given to all trading partners), the FTAA will simplify trade relations among the countries in the region.

Finally, the FTAA could be a building block for the launch of a new round of multilateral trade negotiations under the World Trade Organization (WTO). For example, agreement between trading partners in the Western Hemisphere to liberalize agricultural trade could

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"There is an emerging risk of the United States' being slowly shut out of Latin American markets, while our competitors, particularly the European Union, gain ground. If Latin American countries face lower barriers on imports from the EU than from the United States, they will purchase highly lucrative capital goods from our competitors."

raise concerns in the European Union and Japan about being left behind, creating an incentive for them to accept liberalization in a sensitive area. Similarly, the technical assistance and capacity building that has been part of the FTAA process has enabled many of the smaller countries in the region to implement their Uruguay Round commitments and to develop independent positions on trade policy. Increasing the participation of such developing countries will be crucial to gaining their support for a new, global round of talks. To ensure that the FTAA is a genuine building block for global trade liberalization and not a retreat into regional protectionism, the members should commit to "open regionalism." For example, the FTAA countries could offer equivalent market access to nonmembers that commit to reducing their barriers in a compatible way. If a significant bloc of outside countries were to take up that option, the momentum would quickly build for a new multilateral round of talks under the WTO.

The Costs of Inaction

Moving ahead with the FTAA is a medium-term goal. However, the potential costs of a lack of U.S. leadership are immediate. Three scenarios, all unfavorable to U.S. interests, are possible.

*1) **Protectionism re-emerges in the region.*** In the wake of the Asian financial crisis, several countries in the region have recently shown signs of backsliding on open markets. In December 1997, Brazil introduced several new nontariff barriers (such as discretional licenses for some imported products) and followed this in mid-1998 with an increase in import duties on several products. In response, Argentina has adopted its own import restrictions, including a regime for pre-shipment inspection of goods destined for Argentine markets, import quotas for textiles, and anti-dumping duties for steel. Other countries imposing new trade restrictions since 1997 include Venezuela, Ecuador, and Colombia. Without strong momentum on trade liberalization under the FTAA, such backsliding could continue and even accelerate. The result would be reduced trade and lower economic growth rates, as well as escalating regional tensions. Much of the good work of the past six years could be undone.

*2) **The FTAA process becomes sidelined as countries move ahead with subregional and bilateral trade deals that disadvantage the United States.*** When the administration failed in its bid for fast track negotiating authority in 1997, the expansion of NAFTA to include Chile dropped off the radar screen. In response, the Chilean government pressed ahead and negotiated preferential trade deals with Mercosur (1996), Canada (1997), and Peru (1998). While the administration recently opened negotiations with Chile, there is an emerging risk of the United States' being slowly shut out of Latin American markets, while our competitors, particularly the European Union, gain ground. In the future, if Latin American countries face lower barriers on imports from the EU than from the United States, they will purchase goods and services, including highly lucrative capital goods, from our competitors. This potential outcome is not lost on the Europeans — the EU just this year signed a free trade agreement with Mexico and is in talks with Mercosur, the Caribbean nations, and Chile.

*3) **The FTAA negotiations proceed and produce an agreement that does not reflect U.S. interests.*** Under the formal negotiating structure, the United States and Brazil will co-chair the final stage of the talks, from 2002 until 2005. A lack of U.S. leadership will create a vacuum that could easily be filled by other powerful players such as Brazil. Under another country's leadership, the FTAA could overlook areas of interest to the United States (such as intellectual property protection) and allow continued protection of sectors, such as automobiles, in which the United States is highly competitive. Shaping trade negotiations and building consensus around proposals beneficial to the United States is a lengthy process that requires persistent U.S. leadership. The United States will not be able to step in at the last minute and dictate the outcome.

How to Move Ahead

The new administration must make the passage of fast track negotiating authority a top priority. U.S. leadership in trade negotiations such as the FTAA is impossible without such domestic backing. The new president must also

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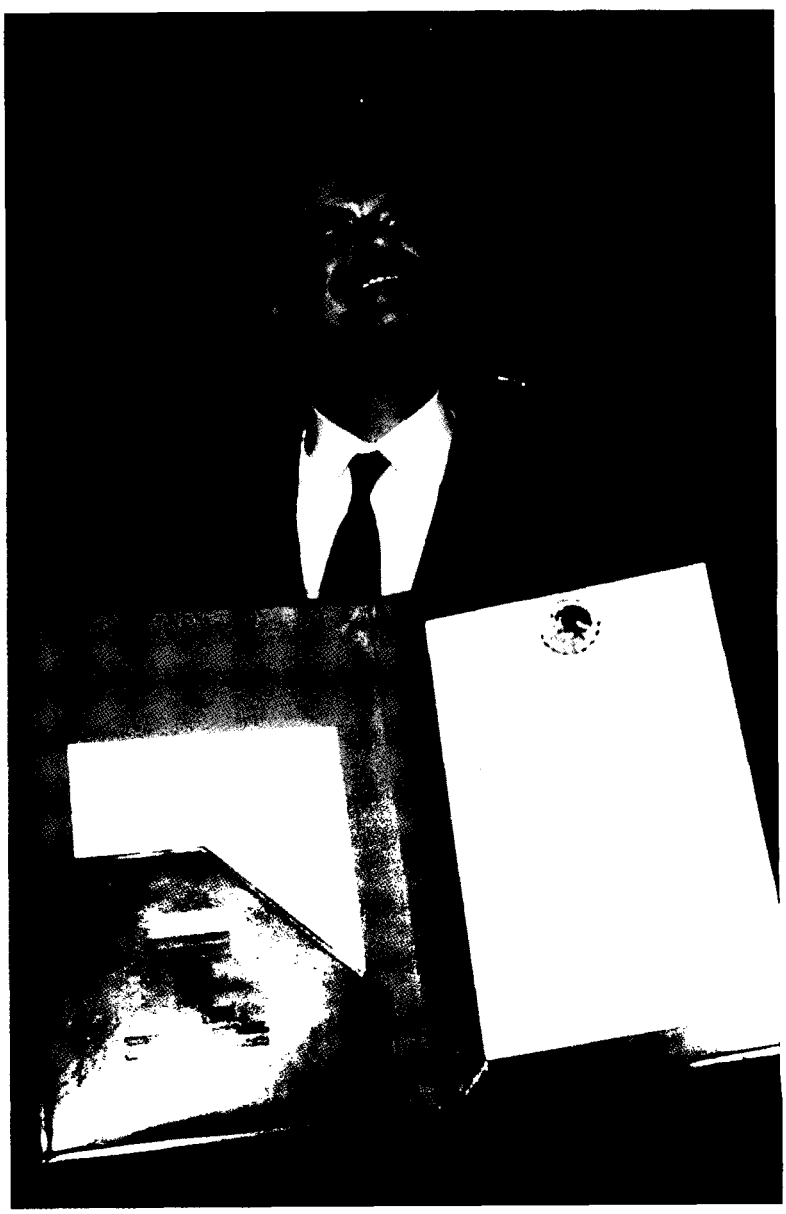
reiterate, early and often, his commitment to leading and completing the FTAA process.

Yet finishing the FTAA on time will require more than fast track authority and tough negotiating. The administration also needs to find innovative ways to address the growing concerns surrounding trade expansion and globalization — issues ranging from environmental degradation to child labor. The challenge is to address these legitimate worries without restricting the international trade and investment that will help alleviate poverty in developing countries. This will require new thinking as well as leadership.

On labor and the environment, the United States must move the debate away from the inclusion of specific labor and environmental conditions in trade agreements. Such conditions are highly unpopular with most countries in the region. They pose significant risks of back-door protectionism by the developed countries (primarily the United States and Canada) and they will do little to improve conditions among our poorer trading partners in Latin America and the Caribbean Basin. Instead, the members of the FTAA must create Pan-American institutions and mechanisms designed to improve standards directly. One model is the North American Development Bank and the Border Environmental Cooperation Commission, established under the NAFTA. These institutions have had some success in financing and coordinating environmental cleanup projects along the U.S.-Mexico border. Similarly, the Commission for Environmental Cooperation has worked to counter smuggling of endangered species and prevent the trans-border movement of hazardous wastes. Similar institutions created under the FTAA would require a genuine commitment of resources and strong enforcement mechanisms. The FTAA parties should also develop new regional environmental treaties to address hemispheric environmental problems.

On labor issues, the United States should call for increased technical assistance to monitor and enforce labor laws. This could be funded both bilaterally and/or multilaterally through the Inter-American Development Bank.

In sum, the FTAA is an opportunity waiting to be seized by the new president — an opportunity to support the wave of economic and democratic reform sweeping Latin America and to expand our prosperity at home by building markets overseas. The benefits to the United States of more prosperous, stable, and democratic neighbors, willing and able to engage in the new challenges facing the hemisphere, cannot be overstated. The challenge for the new president is to take the lead and shape the FTAA process according to U.S. interests while addressing the genuine concerns that many Americans have about the new global economy. ■



POLITICAL FALLOUT: The election last year of opposition leader Vicente Fox as Mexico's new president shows how free trade affects politics. Open economies foster democratic systems.

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A New Democrat tax cut

by Jeff Lemieux

Six questions we should ask

Whatever the economic circumstances, the heavyweights in the Republican Party always seem to trumpet tax cuts for the affluent. In years past, conservatives justified their tax cut proposals with so-called supply side economic theory: Cutting taxes for rich folks would lead to faster long-term economic growth. When President Clinton's economic policies proved that budget discipline, expanded trade, and sensible social policies could spur faster economic growth than the supply-siders would have dreamed — all while making the tax code more progressive — conservatives switched to a moral argument. We should "give back" the new-found budget surpluses, they said, to those who paid the most in taxes, namely the higher-income taxpayers who prospered very nicely under Clintonomics.

Now they're changing their tune again. Following the election, President-elect George W. Bush and Vice-President-elect Richard Cheney began justifying their huge tax cut package ($1.3 trillion over 9 years) with an old-fashioned Keynesian argument: Tax cuts for the rich would stimulate the economy in the short run. That sort of reasoning should make conservative supply-siders and monetarists — who disapprove of fiscal stimulus as an economic policy tool — blush bright red.

Despite the shifting justification, the common thread in Republican policy never changes: tax cuts for those who need them least. More than half of Bush's tax cut would go to the top 10 percent of the income distribution. By contrast, low- and middle-income families would only save a couple hundred dollars a year.

Furthermore, Bush's tax cut package is actually much larger than it sounds. It is phased in slowly, which means that its full impact would be felt only after 2008 or 2009, precisely when the federal government will need every penny to finance retirement benefits for the huge baby boom generation.

Tax Cuts the New Democrat Way

President Bush will probably back off from his most grandiose campaign promises for tax cuts, but New Democrats should remain cautious. Although most economists expect the budget surpluses to persist, Congress is appropriating funds at a breakneck pace. The official projections of large surpluses rely on the assumption that Congress will restrain itself in the future, which it shows no sign of doing.

More important, there are right ways and wrong ways to cut taxes. Here are the six important questions New Democrats should ask about any tax cut:

1) Is the size of the tax cut consistent with paying down the national debt? Debt reduction is not only sound economic policy, but also will improve the government's financial position in preparation for the baby boomers' retirement. If the new administration and Congress achieve only one thing, it should be staying on track to pay off our nation's debt.

2) Is it progressive? It's now clear that progressive taxation in the United States is consistent with a vigorous economy, and Americans view progressivity as the fairest way to raise funds for the government.

3) Does it foster new savings, especially among families who would otherwise have difficulty setting money aside? Tax cuts that prompt new private savings would have roughly the same beneficial economic impact as debt reduction, and would help a new generation build a modicum of financial wealth (see page 32).

4) Does it foster New Economy investments in technology, research, or training that will raise productivity growth? Robert D. Atkinson makes a persuasive economic case for an enlightened, New Economy approach to investments in his keynote article on page 6.

5) Does it add incentives for work, helping workers rise into the middle class? Will Marshall's article, on page 34, highlights some innovative tax policies that would reward work, and Anne Kim's sidebar, on page 40, sketches a path to political compromise on the child tax credit.

6) Does it give workers more control over their pensions or health care, helping secure those benefits in an ever-changing economy? David Kendall argues on page 26 that tax cuts should be used to reduce the number of uninsured Americans, and to bolster coverage for families who already sacrifice to afford health insurance.

Few tax cuts can meet all those criteria, but those worthy of consideration by New Democrats should meet as many as possible. Republicans should set aside their strained arguments for tax cuts for the affluent. Instead, they should embrace a New Democrat tax package that works toward important national goals. ■

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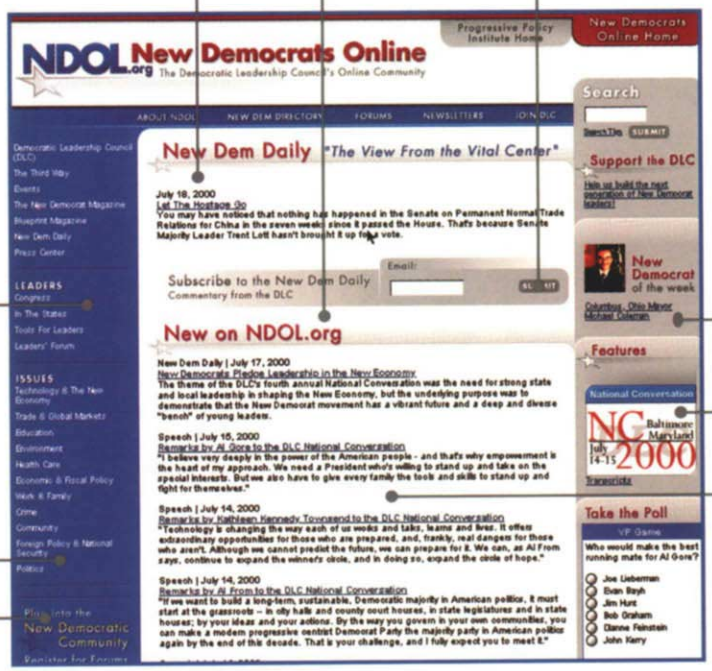
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Let The Hostage Go
You may have noticed that nothing has happened in the Senate on Permanent Normal Trade Relations for China in the seven weeks since it passed the House. That's because Senate Majority Leader Trent Lott hasn't brought it up for a vote.
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New Democrats Pledge Leadership in the New Economy
The theme of the DLC's fourth annual National Conversation was the need for strong state and local leadership in shaping the New Economy, but the underlying purpose was to demonstrate that the New Democrat movement has a vibrant future and a deep and diverse "bench" of young leaders.
Speech | July 15, 2000
Remarks by Al Gore to the DLC National Conversation
"I believe very deeply in the power of the American people - and that's why empowerment is the heart of my approach. We need a President who's willing to stand up and take on the special interests. But we also have to give every family the tools and skills to stand up and fight for themselves."
Speech | July 14, 2000
Remarks by Kathleen Kennedy Townsend to the DLC National Conversation
"Technology is changing the way each of us works and talks, learns and lives. It offers extraordinary opportunities for those who are prepared, and, frankly, real dangers for those who aren't. Although we cannot predict the future, we can prepare for it. We can, as Al From says, continue to expand the winner's circle, and in doing so, expand the circle of hope."
Speech | July 14, 2000
Remarks by Al From to the DLC National Conversation
"If we want to build a long-term, sustainable, Democratic majority in American politics, it must start at the grassroots -- in city halls and county court houses, in state legislatures and in state houses; by your ideas and your actions. By the way you govern in your own communities, you can make a modern progressive centrist Democrat Party the majority party in American politics again by the end of this decade. That is your challenge, and I fully expect you to meet it."
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